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Securities Industry
Trends

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AN ANALYSIS OF EMERGING TRENDS IN THE SECURITIES INDUSTRY
Produced by the SIA Research Department

Vol. XIV, No. 6

November 1, 1988

OBSERVATIONS ON THE RETAIL BUSINESS

Substantial change has occurred within the securities industry since last October. This issue of Trends focuses on and quantifies key shifts on the retail side of the business.[1]

To provide a perspective on the retail business today, let's look at two fundamental questions.

- o What do the numbers show?
- o What are some of the key challenges facing those responsible for the retail side of the industry?

What's Happened Since the End of 1985?

Let's begin by taking a look at the numbers via setting up a hypothetical situation.

Having had an outstanding year in 1985, you decided back then to realize a lifetime ambition. You worked out a sabbatical and took off for a remote island to write the definitive novel of Wall Street -- which you planned to title "Bon Vanities." And now, after being completely incommunicado through all of 1986, 1987 and year to date 1988, you've returned. Alas, your novel has been viciously rejected by 612 publishers. So, you've ended your writing career and decided to resume your vocation as a retail sales and marketing executive. Welcome back.

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[1] Based on a presentation by Adrian L. Banky at SIA's September, 1988 Sales and Marketing Conference. SIA welcomes contributions to Trends from all sources, from member firms as well as others, relating to the securities industry and capital markets. Please send submissions to the attention of Jeff Schaefer or George Monahan, SIA Research Department.

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After being out of touch for the past two years and nine months, you're naturally very curious about how things have gone in the markets and the business. Naturally, you ask for some numbers on what's happened during your absence.

"What about the DJIA?" Well, prior to your departure the Dow had been moving splendidly, going from about 900 at the end of 1981 to an all-time year-end record of 1547 when you sailed at the end of 1985. But today, it's up to about 2100! Outstanding news on the Dow...from 1547 to 2100. Great!

How about volume? You receive some more stunning good news: average daily volume on the NYSE charged strongly ahead -- from a then-record 109 million shares in 1985 to 170 million shares 1988 year to date! A 56% increase in less than three years. Looking good!

Next, you ask about revenues from mutual fund sales which exploded 16 times over from 1980 to 1985 -- reaching $1.6 billion for 1985. With that sort of phenomenal growth you were obviously concerned the pendulum might have swung the other way during your absence. Well, more great news: we're on track to do another phenomenal $1.6 billion in fund sales this year! Terrific! Isn't this a great business?

Now with the Dow and NYSE volume up and fund sales holding strong, you hope that commission revenues may also have done well. Right again. Commissions rose from $8.2 billion in 1985 to a pace that may exceed $9 billion for 1988!

And so, the picture is looking very, very good. But" aha," you say. Maybe only retail blossomed during your absence; the rest of the business may have turned soft. Your fears are totally dissolved given total revenues in the securities industry. In 1985, you left a $39 billion industry; a record high. Now, you are back and the trend suggests we could have a $51 billion business in 1988! Revenues are up 31%! Wow -what a business!

You're feeling just great. Dow and volume up. Mutual fund sales still very strong. Commissions and industry revenues also up. Terrific! Your only regret is missing all the fun.

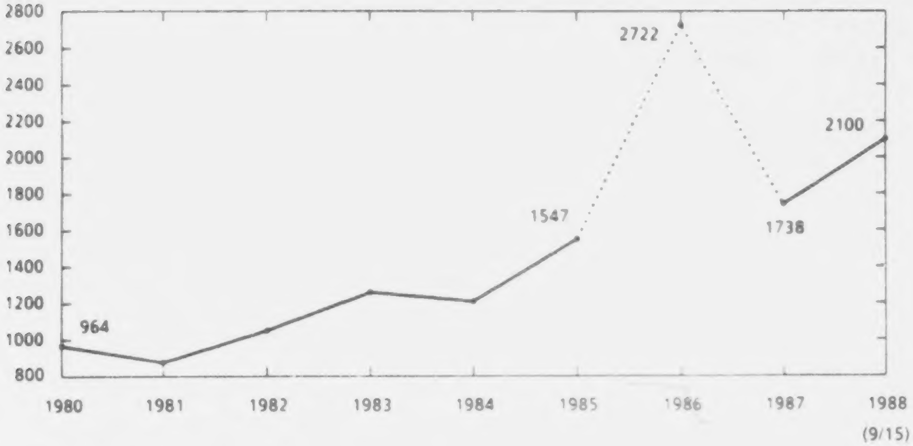
Time to Look Behind the Numbers

But, after you basked a bit in the glow of all these warm numbers, you begin to get a little curious about some of the details of the past two years and nine months. For example, you ask, "Did the Dow march steadily up to the 2100 area -- or was there some volatility?"

Well, yes, there was some volatility. In fact, about 1,000 points worth of volatility during just a matter of weeks in 1987. **Exhibit 1** reveals that while we are indeed up 550 points from the time you left at the end of 1985, we're also down over 600 points from the high reached in August, 1987. You missed a true roller coaster ride.

Exhibit 1

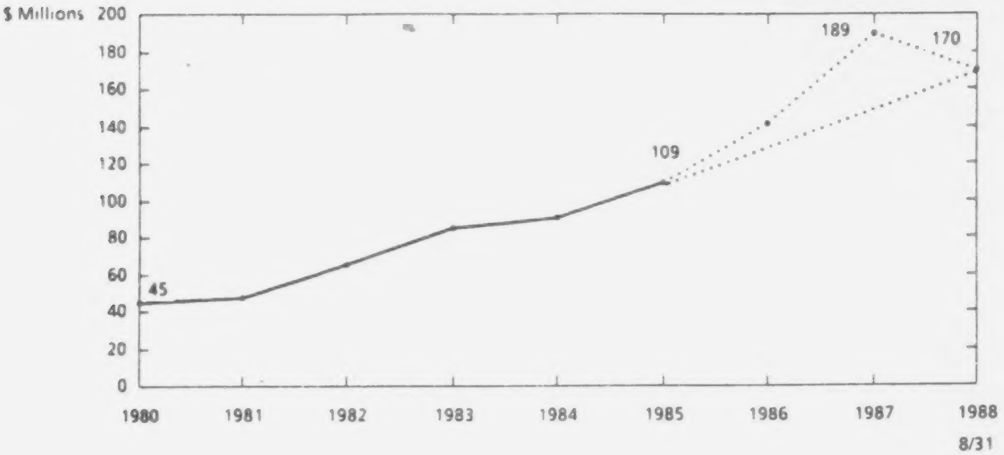
DJ Industrials



And how about the pattern in NYSE volume? **Exhibit 2** shows that NYSE daily share volume, while well up from 1985 levels, has turned south from last year's 189 million share daily average. Hence, strongly up from 1985, but down 11% from last year (not even adjusted for increased role of specific trading strategies such as dividend capture programs).

Exhibit 2

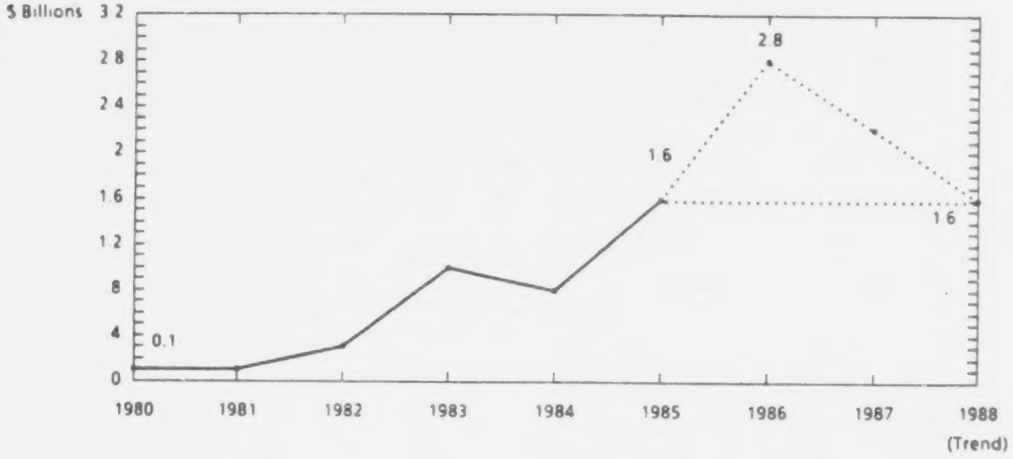
NYSE Average Daily Volume



Next, you want a more complete picture of mutual fund sales, as contained in **Exhibit 3**. Yes, we surely did hold at that phenomenal $1.6 billion during your absence. But that's down a dramatic 43% from the more phenomenal, and record $2.8 billion in 1986! Now the picture is starting to look quite different.

Exhibit 3

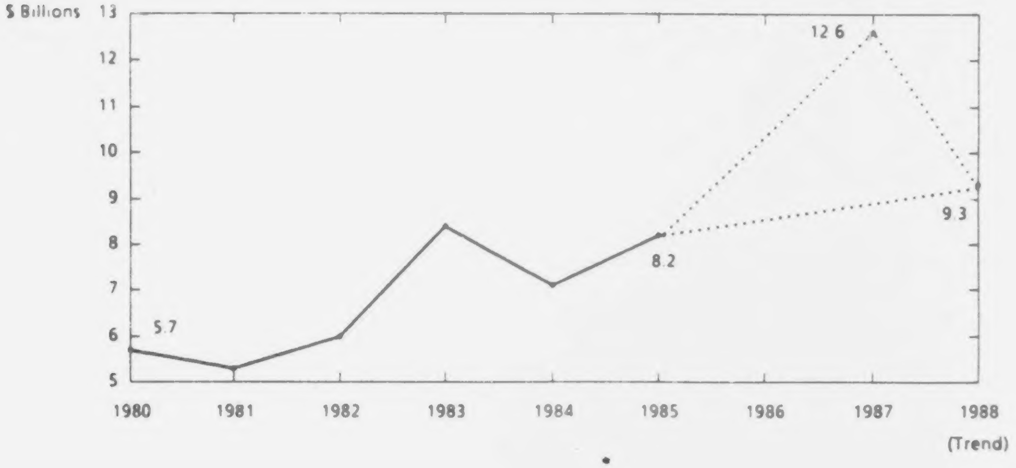
Securities Industry Revenues from Mutual Fund Sales



What about commission revenues? **Exhibit 4** shows that commissions did rise from $8.2 billion to $9.3 billion during your absence. But last year, commissions shot up to $12.6 billion. So, we're clearly up from 1985, but down 26% from 1987.

Exhibit 4

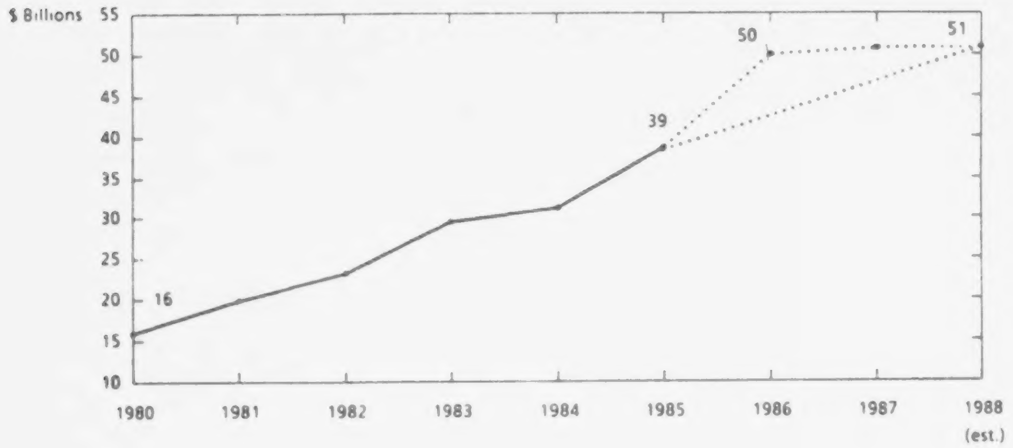
Commission Revenues



And how about total industry revenues, which are displayed in **Exhibit 5**? The $51 billion certainly looks good in relation to the $39 billion of 1985. But, total revenues have been essentially flat since 1986.

Exhibit 5

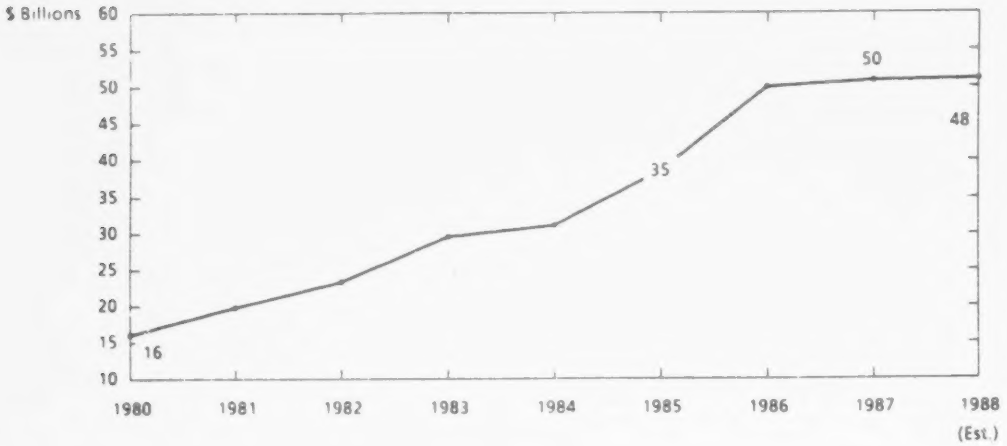
Securities Industry Revenues



With revenues flat for three years, you immediately hope that the expense side has been flat also. Not quite, according to **Exhibit 6**. Industry expenses moved up sharply in 1987, though happily, the year to date trend suggests total expenses in 1988 could be down a couple of billion dollars from 1987.

Exhibit 6

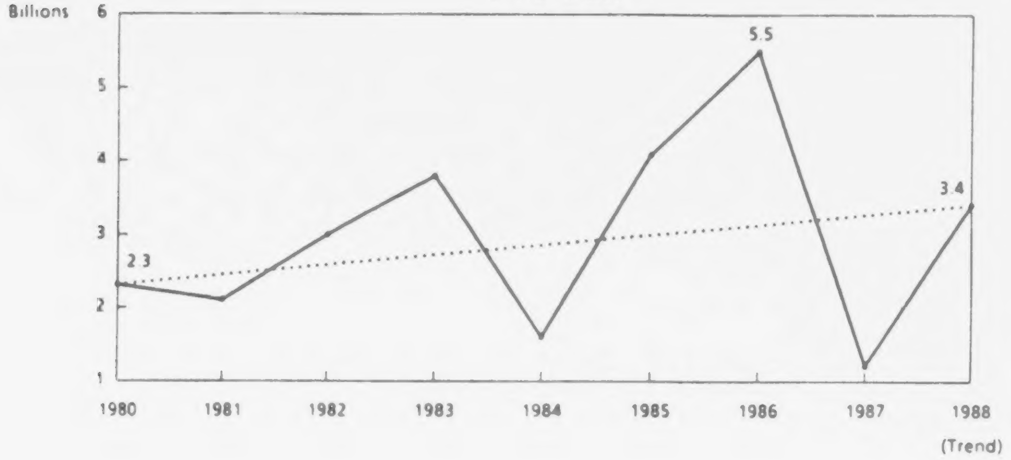
Securities Industry Expenses



At this point you're ready, but not eager, to see the bottom line. **Exhibit 7** shows that when you left in 1985, the industry earned a record $4.1 billion pre-tax that year. In 1986, it reached a new record $5.5 billion. But then, profits dove to $1.2 billion for 1987, including a $2.1 billion loss in the fourth quarter. If the second half of this year mirrors the first half, it appears pre-tax net will come in around $3.4 billion.

Exhibit 7

Securities Industry Net Income
Pre-Tax



In **Exhibit 7**, the line drawn from the $2.3 billion of profits in 1980 to the $3.4 billion point of 1988 is the trend line of profitability. If the business actually grew in such an orderly fashion, this would be a far different business than it is and has been. The industry's bottom line has been more volatile than the markets themselves.

Although the bottom line of firms has been less than satisfactory, shouldn't brokers still be doing well? After all, a lot of business is being done.

Exhibit 8 shows that the average retail RR earned $80,000 in W-2 compensation for 1985. RR earnings should correlate with various barometers. For example, take mutual fund sales. You'll recall they were at $1.6 billion for 1985, and the trend line suggests fund sales will be about $1.6 billion again this year. So, based solely on the fund sales barometer, one would expect that the average earnings of retail brokers would hold steady at about $80,000.

But, based on total commissions, which have grown since 1985, one would expect broker earnings of about $90,000. Moving up the line, the growth in total revenues would suggest $105,000. The higher level of the Dow would suggest $109,000. And, the increase in NYSE trading volume would suggest $125,000.

Very pleasant and rosy expectations. What actually happened?

Exhibit 8 also shows the real story. If the second half of this year mirrors the first, average retail RR earnings will be down to about $63,000 -- much below the expectation one would get from looking at the various barometers.

Exhibit 8

Average Retail RR Earnings -- Expectation vs Actual

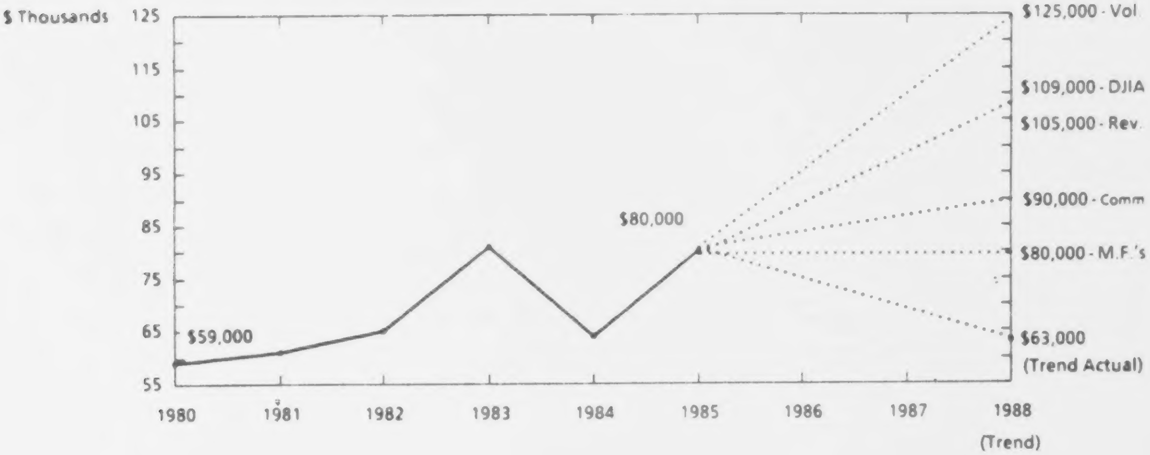
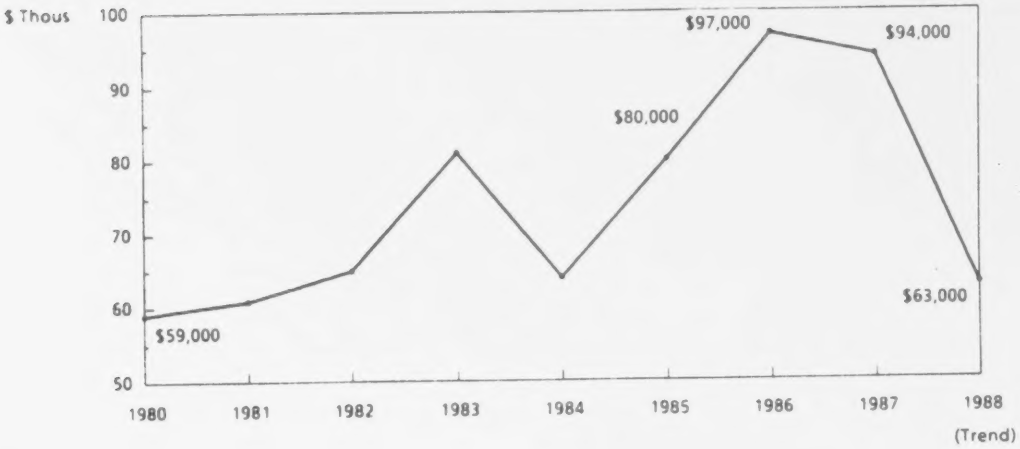


Exhibit 9 shows the year to year plottings in average retail RR earnings. They peaked at $97,000 for 1986; were an excellent $94,000 for 1987; and are now dropping back to what looks like about $63,000 for this year. Note the $63,000 isn't much different from the $59,000 of 1980. So, if you compare actual 1987 broker earnings with the trend for 1988, it's down 33%. Quite a drop.

Exhibit 9

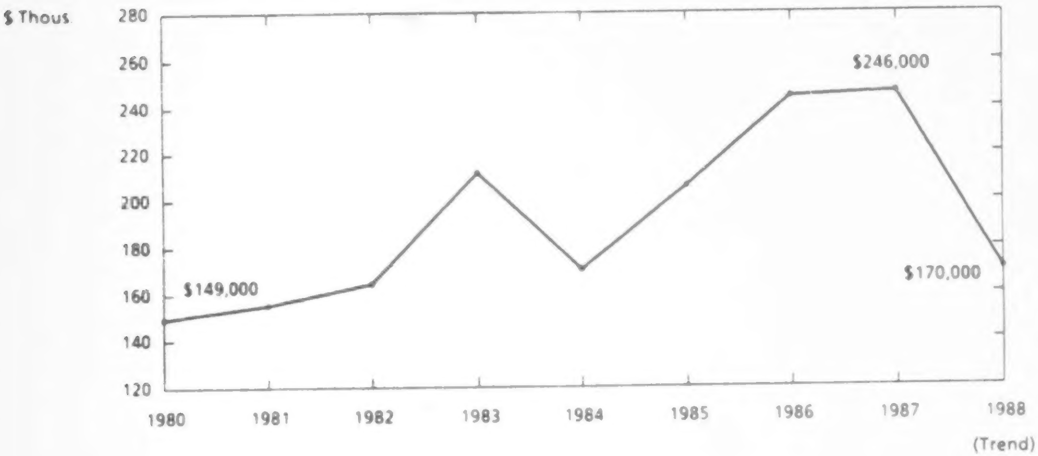
Average Retail RR Earnings -- Expectation



That suggests that average production followed the same path -- and it did, as shown in **Exhibit 10**. This figure went from $246,000 last year down to an estimated $170,000, representing a 31% reduction in average production.

Exhibit 10

Average Retail RR Production



You're baffled. With all the barometers looking good, how could there be a sharp drop in retail RR earnings and production? It just doesn't make sense.

Well, as all of us who lived through the sea change that began last October know with excruciating clarity, there are fundamentally two reasons. First, concerned about uncertainty, investors have hunkered down, gone to the sidelines, reduced their activity. So, compared with last year, fewer tickets are being written. Second, concerned about risks, investors have gravitated to more conservative investments. So, again compared with last year, the products that are being sold tend to carry lower commissions and thus the sales credit per transaction is down. Fewer tickets with lower credits will yield lower RR production and earnings every time. We could go into more detail, but in essence, that explains the seeming anomaly. It's a different business.

You pause, ponder and then ask how the people running the firms view the situation. SIA recently surveyed the CEOs of 67 mid-size firms, asking them to identify their principal concerns. Here are the top three short-term concerns, almost entirely relating to profitability:

1. Adequacy of net profits.
2. Adequacy of gross revenues.
3. Profit margins.

Looking out three to five years, the top three longer-term concerns were entirely profitability:

1. Achieving solid profitability.
2. Profit margins.
3. Being able to at least break even during poor market periods.

What Now?

Dropping the hypothetical situation, what sort of story have we seen? Is it depressing? Is it pessimistic?

Maybe not! As Mark Twain once commented on Wagner's music, "It's not as bad as it sounds." The following reasons may show why the picture is not all that bleak.

1. We are doing a lot of retail business today. As we just saw, today's numbers when compared with those of just a few years ago are pretty darn good; for example, commissions, mutual fund revenues, the Dow, trading volume, even average production. The problem relates to our short-term orientation. We tend to compare things to the very recent past, and in this instance the recent past was an unprecedented, record-breaking time. But we shouldn't lose sight of the fact that we are still doing a lot of retail business today. Lots of brokers and offices are doing extremely well by any standard.

2. Among the numbers we looked at that were down substantially were average production and earnings. But again, the big drop is only in relation to the recent holiday we had. When one takes a longer view -- which is an important view to take in an industry characterized by cyclicality and volatility -- a different picture emerges. Consider RR earnings. During the 1980s, the average retail RR has done very well. If you take the first three years of this decade, RR earnings averaged $62,000--not at all bad. Then, if you take the most recent three years, the average is $85,000. Even better. Every year can't be a record, but the numbers are not only impressive, but getting better. And, we're talking "average" here. The better brokers, by definition, do still better.

3. Investor preferences have clearly changed. But investors still have financial needs; if anything those needs are greater than ever. And there's no one better able to meet those needs and address those preferences than the people in this business. We have the products, expertise, and accounts. We can do a terrific job for clients, one that reflects their concerns, uncertainties, aversions, and goals. Some of us may need to alter approaches or heighten efforts, but investors do need help and the business is there to be done.

4. If we do that terrific job for clients during this period, we should be in a superb position when the investment climate again brightens, which it inevitably will. (On that score, a recent SIA study revealed 91% of a large cross-section of sales and marketing executives in our business believe that at some point within the next three years, equities will once again become highly attractive.)
5. At the firm level, most are still generating considerable, though not record-breaking, gross revenues. If you have decent gross, there is the opportunity to manage in ways that will produce net. A good deal of progress is being made as firms go about adapting to the new climate.

The Problems We Face

So, with some longer term perspective, today's numbers aren't so terrible and the situation isn't all that bleak. Nevertheless, there are some serious challenges.

As we talk to one another about problems and challenges, what do we hear? Well, we hear about trade and budget deficits being too high. Election year uncertainties. Inflation jitters. The dollar. The markets being still vulnerable. We hear concerns about institutional domination. The flight to safety. Our newer brokers don't know how to deal with the present environment. And there's program trading in its varied forms. We also hear about customers on the sidelines. Frozen brokers. Costs being too high. Fierce competition. The fear that corporate profits are peaking. Investment taxation too high. Managers no longer sales leaders. Markets and prices jumping around too much. And, the securities business is getting bad publicity.

We've left out forest fires, hurricanes and the drought, but the list goes on and on. Clearly, there is no shortage of problems or tough challenges.

But, in trying to sort out the boatload of challenges faced by the retail side of the business, there are three that are especially key. Let's focus on them...briefly and without belaboring them.

Three Key Retail Challenges

The first key challenge is: Do our customers really understand how their investments have performed over the last two, three or five years?

There are many, many customers who have enjoyed fine and even excellent performance on their investments over the longer term. Yet, of the many who have benefited from fine performance, how many feel or think otherwise? Far too many do in fact think otherwise. By and large, the numbers for most investors are good when viewed over a period of years, but we as an industry have not done nearly enough, first, to put those performance numbers together...and, second, to help our customers understand those numbers in a reasonable context. Remedial action on this point is not only a key challenge, but a great opportunity.

A second key challenge also relates to customers and it is this: Have we done enough to develop "investment programs" for our customers; programs that are long-term, well conceived and systematic?

Perhaps a little vignette will illustrate this point. In the days immediately following October 19, 1987, all of us talked with investors who were shocked, disappointed, scared, upset or worse. However, one person with whom I talked was none of those things. He had taken a hit like the rest of us, but it didn't bother him much. He said:

o First, I've been following an investment plan on a consistent basis for a number of years.

- Second, over that period I've done quite well, even with the market break taken into account. I am actually ahead of what my plan calls for.
- Third, my investments are diversified -- munis, equities, corporates, real estate, money markets, etc.
- Fourth, I put in and reinvest new funds each month, so in effect I dollar cost average.
- Fifth, my investment goals are long term, and so I take a long term view of my investments. I don't get too excited by short term swings -- up or down.

That's not heavy duty financial planning, but it is an investment program that is long-term, well-conceived and systematic. More of our customers should be convinced to establish sound programs tailored to their individual needs. Accomplishing that end is a key challenge...and a big need.

The last key challenge is this: Do we have business plans that enable us to operate at least satisfactorily over all phases of the cycle? For many firms, clearly the answer is no. In the first quarter of 1988, 32% of NYSE firms doing business with the public lost money. In the second quarter, 42% lost money. This is an incredibly difficult challenge, but it can be met. We are aware of a handful of firms that during the good years developed plans designed to keep them profitable even if revenues were to drop by 20%, 30% or as much as 40% -plans which have since been implemented, and successfully. But by and large, as an industry we still face a big challenge in operating satisfactorily when the cycle moves off record-breaking highs and swings to levels that would have been sensational just a few years ago. And that is particularly true on the retail side. It's a key challenge, the importance of which is being borne out in the P&Ls around the industry.

Perhaps these numbers and observations help provide some added perspective. After you returned from your sabbatical and saw some of the current data you marveled, "Isn't this a great business!" You bet it is!

Adrian L. Banky
Executive Vice President and General Manager
Securities Industry Association

VOLUME

	JUL 1988	YTD 1988	JUL 1987	YTD 1987	% CHAN YTD 1988-1987
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	145.7	167.3	177.3	181.1	-7.6%
AMEX (MILS.)*	8.4	10.1	12.4	13.7	-26.2%
NASDAQ (MILS.)*	111.8	125.1	148.3	149.9	-16.6%
REGIONAL EXCHANGE (MILS.)*	0.0	0.0	25.6	27.5	-100.0%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$101,435	$1,044,556	$163,895	$1,426,618	-26.8%
AMEX (MILS.)	2,463	25,321	4,222	40,585	-37.6%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	6,759	64,282	9,481	96,452	-33.4%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	14,805	133,588	15,465	157,856	-15.4%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	54.7%	53.0%	49.8%	51.3%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	8,841	81,063	17,784	146,633	-44.7%
AMEX OPTIONS	3,354	28,059	4,733	41,165	-31.8%
COMMODITY	20,185	184,477	22,407	171,520	7.6%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

YIELDS

(MONTHLY AVERAGES)

	JUL 1988	JUL 1987	BASIS POINT CHG 1988-1987
BOND BUYER INDEX (20 BOND)	7.76%	7.72%	4
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	9.96	9.42	54
Baa CORPORATE	11.11	10.61	50
RATIO Aaa CORPS. TO Baa CORPS.	0.90	0.89	1

PRICES

(END OF MONTH)

	SEPT 1988	SEPT 1987	% CHAN SEPT 1988-1987
DOW JONES INDUSTRIALS	2112.91	2596.28	-18.62%
STANDARD & POOR'S 500	271.91	321.83	-15.51%
NYSE COMPOSITE	153.57	180.24	-14.80%
AMEX MARKET VALUE INDEX	301.63	356.45	-15.38%
VALUE LINE COMPOSITE	234.71	279.41	-16.00%
NASDAQ COMPOSITE	387.71	444.29	-12.73%

UNDERWRITING

	THIRD QUARTER 1988	THIRD QUARTER 1987	% Change 1988-1987
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$206,267.0	$229,203.3	-10.0%
Common Stock	$23,757.8	$35,913.6	-33.8%
# of Common Stock Issues	312	776	-59.8%
Preferred Stock	$5,245.9	$10,138.5	-48.3%
# of Preferred Stock Issues	93	143	-35.0%
Corporate Debt	$177,263.3	$183,151.2	-3.2%
# of Corporate Debt Issues	2,296	1,992	15.3%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$61,959.3	$58,050.6	6.7%
# of Issues	2,621	2,543	3.1%
Competitive	$19,846.7	$18,250.0	8.7%
# of Issues	2,569	2,669	-3.7%

Source: IDD Information Services

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
Prices Charged Retail Clients	New survey, to be released in November, details the prices individual investors pay for certain investment services. It is based on data from 77 SIA member firms, including large national wirehouses, regional firms, and smaller local firms. Commissions on agency stock and option transactions, fees for such items as postage and handling, IRA and pension accounts, legal transfers, and central asset management accounts are presented. Commission discounting, including the amounts of discounts and the extent to which discounts are given, is also discussed.	Bill Jordan SIA
Mutual Fund Investment -- After the October 1987 Market Break	Two-part study reviewing activity levels in mutual funds and reporting results of survey on mutual fund investor actions and attitudes. Sample highlights include: 1. Sales volume of stock, bond and income funds in 1988 is much more subdued than a year ago, but continues to be twice the level experienced in 1984. 2. The majority of fund owners, regardless of fund type, have taken little action since October 1987 to either redeem or exchange their funds.	ICI 1600 M Street, N.W. Washington, D.C. 20036
"Studies on Equities Markets"	Issue contains a collection of six articles examining certain technical issues related to equity market performance. The first three articles discuss the international character of the crash, including the worldwide transmission of the disruption from one national stock market to another. The last three articles examine the role of equity related margin requirements in the U.S.: 1. the diverse margin rules in various markets are summarized; 2. analytical and conceptual issues on "consistent" margins across markets is discussed; and 3. new evidence is introduced on how margin requirements may affect stock market activity.	Quarterly Review Federal Reserve Bank of New York 33 Liberty Street New York, N.Y. 10045
"The danger of revenue neutral"	Article criticizing the use of a static revenue forecasting model by the Jt. Tax Committee. Because of the considerable dynamic impact of lower capital gains taxes in stimulating economic growth, use of a static revenue model is particularly inappropriate. When it comes to taxation policy, Congress' "static model" has not thought for tomorrow.	Institutional Investor October 1988

Item	Description	Source
"The Bear Facts"	Although most firms have not cut payouts in response to a tough market, brokers are working harder than ever and taking home less. Nevertheless, the major firms are a little closer together in what they pay than they have been in the past, but there is disagreement over which way compensation will go in the months ahead.	Registered Representati October 1988
"Done Deal? -- FSLIC'S Bailouts May Come Apart"	Since mid-May, the embattled FSLIC has signed contracts providing an estimated $25 billion in subsidies to encourage takeovers of insolvent thrifts. But in the haste to do bailouts, FSLIC and its parent may be making deals that are destined to come apart. A key factor in the ultimate fate of these subsidized transactions is the uncertainty over the value -- or lack thereof -- of various assets of the troubled thrifts.	Barron's 10/24/88
"Tax Policy"	Special report detailing tax policy positions of Bush and Dukakis. Despite the disavowal of any interest in raising taxes, both presidential candidates favor significant tax policy changes. Examines proposals, estimates where available, and past records.	Bureau of National Affairs 10/28/88
"Derivative" Mortgage Securities and Their Risk/Return Characteristics"	The majority of residential mortgage loans originated in 1988 will be transformed into mortgage-backed securities, a large part of which will subsequently be turned into derivative mortgage instruments such as strips, REMICS and CMOs. In these products, cash flows from mortgage-backed securities are rearranged to suit the risk and maturity preferences of investors. This article analyzes the risks and rewards embodied in these new instruments under changing market and economic conditions.	FDIC Banking Review Fall 1988
"The Return of Second-Hand Rose"	Is Sandy Weill pushing his luck taking on Primerica? The stock market has reacted skeptically, but this article which reviews Primerica's troubles and Weill's career ends up putting its money with Weill.	Fortune 10/24/88

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Vol. XIV, No. 7
December 7, 1988

PERSPECTIVES ON THE SMALL REGIONAL FIRMS

Highlights

1. Commissions of the Small Regional firms, their main revenue source, fell 32% in 1988 (based on first half data), or back to levels of three years ago.
2. Last year, Small Regionals' trading profits fell to $36 million, their lowest level since 1982. This year, however, first half results project more than a 50% recovery to an annual $55 million trading profit.
3. Faced with a 20% drop in revenues in 1988, Small Regionals have quickly moved to contain costs, slashing expenses by 23% in 1988. The "net" result: last year's $14 million loss for this group is projected to be reversed to a $3 million pre-tax profit.
4. Despite commendable cost cutting by the Small Regionals, this year's 0.7% profit margin is the worst showing, sans last year's loss, for this group during the Eighties and the lowest of all firm groups except the National Full Line firms.
5. The gross production of retail RRs at regional firms with fewer than 50 RRs fell 28% after October's crash, as did these firm's retail RR earnings. This resulted in a 29% drop in net production, a steeper drop than the 18% felt by all firms.

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Introduction

This year, the securities industry has often been characterized as a tough, marginally profitable (if at all) business to be in, especially for the highly retail oriented firm. Terms such as anemic, worsening, pare-backs, etc., have proliferated in press descriptions of securities markets and firms. In a snapshot view of today's markets, as most readers of this issue of Trends are painfully aware, these are apt descriptions. But if one word describes the securities industry best, it's volatile. A videotape of the long haul, however, would show various industry areas traveling differing paths -- some on Everest climbs, others on bobsled runs and still others, such as profits, on a continuous roller coaster ride (but riding the downslope in recent periods).

There have been many forces over the past few decades which have affected, and continue to change, the nature and fortunes of the securities industry. Prominent among these have been deregulation, competition, globalization, product proliferation, institutionalization, etc.

One of the most striking changes in the industry has been the basic shift in revenue sources over time. Prior to the deregulation of commission rates in 1975, the securities business was almost entirely an agency equity commission driven business. As long as there was volume, the industry enjoyed a nice, safe income stream -- protected from the risks of volatility from principal businesses. And prior to May Day 1975, this business line was also protected from price competition. Although some firms, including many regional firms, have continued to concentrate on this business, for the industry as a whole this scenario has changed radically.

Bread & Butter Businesses

For the total securities industry, which includes all firms, investment banks as well as regional firms, commissions have gone from over three-fifths of industry revenues in 1965, to less than one-fifth in 1988 (Table 1). Meanwhile, the principal businesses today are the bread and butter source for the securities industry as a whole. Trading and investment profits, principally debt trading, have risen from less than 10% of 1965 industry revenues to over one-quarter during the past few years. This excludes underwriting profits, which have consistently generated around 10% of revenues (although becoming a more and more concentrated activity among firms), and other investment banking activities such as M&A and private placements. Profit margins, discussed later, also have lessened over the years. Table 1 illustrates how the main components of revenue have shifted in importance over time.

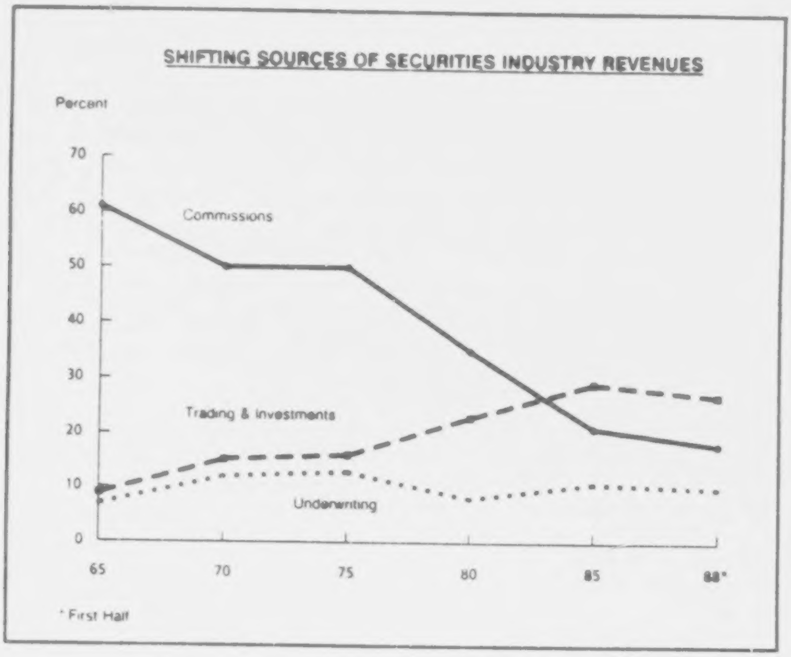
Table 1

SHARE OF SECURITIES INDUSTRY REVENUES

(Percent of Total Revenues)

	1965	1970	1975	1980	1985	1988
Commissions	60.9	49.8	49.9	35.4	21.3	18.3
Trading and Investments	8.8	15.1	15.6	23.1	28.5	26.8
Underwriting	7.2	11.9	13.3	8.3	11.0	10.0
Other Revenues	23.1	23.2	21.2	33.2	39.2	44.9
Profits	0.4	14.9	13.6	14.1	10.7	6.7

Note: Based on all NYSE member firms doing a public business; 1988 data based on first half.



The downward trend does not mean that there has been an actual drop in commission dollars, only that their relative importance has decreased. Industry commissions have actually increased year to year. They grew from just $1 billion in 1965 to around $9 billion this year (based on six-month figures).

Trading profits and investment gains, meanwhile, grew from $200 million in 1965 to a projected $13.7 billion this year. Underwriting, which holds pretty steady as a percent of total revenues over the decades, grew from about $170 million in 1965 to a projected $5.1 billion this year (Table 2).

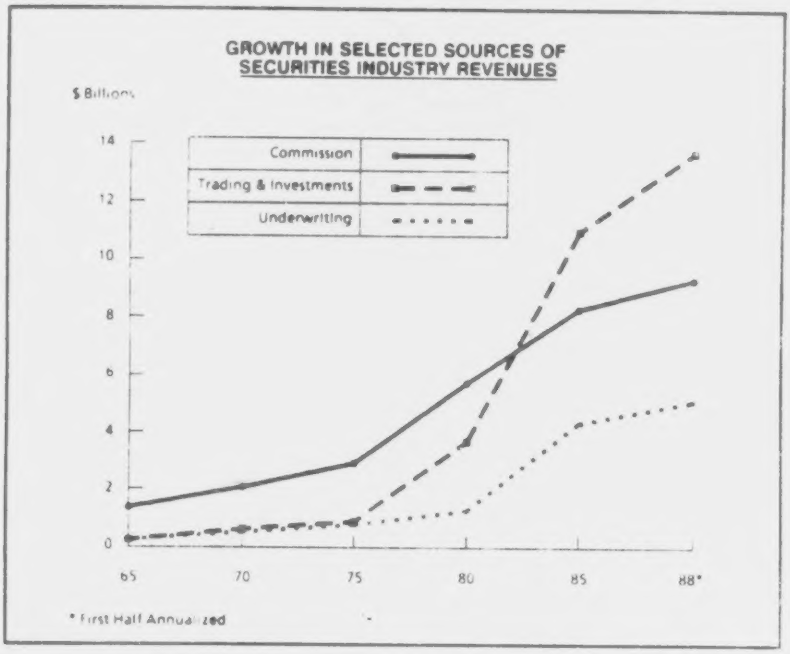
Table 2

GROWTH IN SELECTED SOURCES OF REVENUES

(In $ Billions)

	1965	1970	1975	1980	1985	1988
Commissions	1.4	2.1	2.9	5.7	8.3	9.3
Trading and Investments	0.2	0.6	0.9	3.7	11.0	13.7
Underwriting	0.2	0.5	0.8	1.3	4.3	5.1

Note: Based on all NYSE member firms doing a public business; 1988 data based on first half.



The long-term trend in Table 2 does not show the volatility in intervening years and quarters, however. For instance, commissions went from $8.3 billion in 1985 to a projected $9.3 billion this year. That's an upward trend. However, it already hit $9.3 billion in 1986, shot up to $12.6 billion last year and fell back to 1986 levels this year!

Trading and investment revenues rose from $11 billion in 1985 to a projected $13.7 billion this year. But they were likewise volatile. This year's figure, just like commissions, was already attained in 1986.

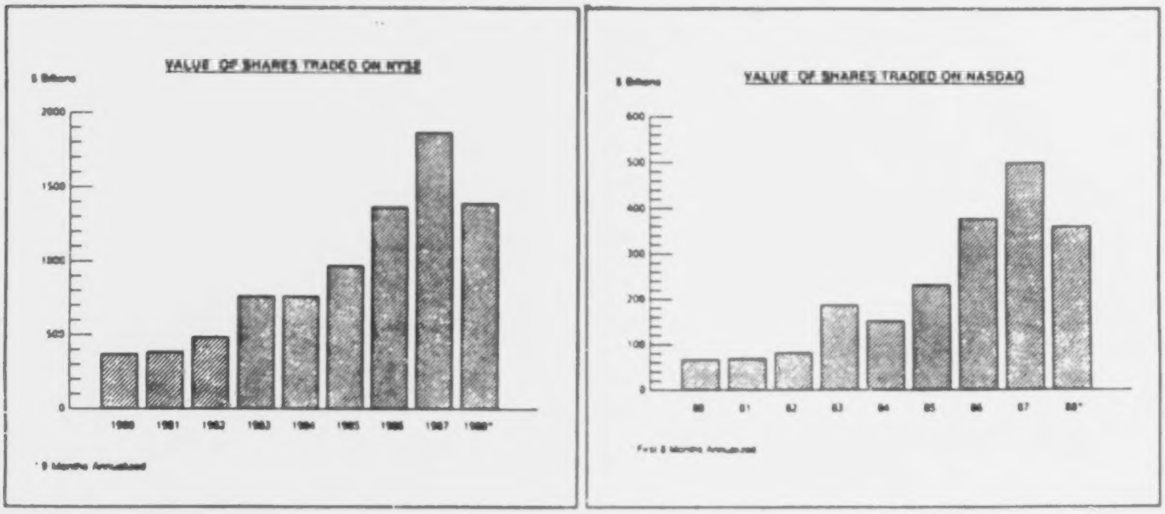
So, again, the long-term trend is up but in any given year you can toss a coin to project if next year's trend is going to be up or down relative to the previous year.

Underlying Equities

The growth in commission dollars has been sparked by incredible growth in volume or, more importantly, the value of equity trading, particularly during the Eighties. Table 3 shows the growth in the dollar value of trading on the NYSE and NASDAQ during the Eighties.

Table 3

VALUE OF EQUITY TRADING



Increased Institutionalization

Besides the price competition which has, in part, contributed to the decline in commissions' relative importance, demographics have also altered the commission picture, tipping the scale more and more toward the institutional side. Table 4 shows how the holdings of U.S. equities, once almost entirely held within the household sector, has shifted to a three-fifths/two-fifths split between households and institutions, and illustrates how these two sectors are converging.

Add to this altered holdings picture the increased dominance of institutions in the marketplace itself -- NYSE volume is now 75% institutional (SIA's Investor Activity Report) with the options and futures businesses almost entirely institutional -- and it's evident that retail firms are left with an ever shrinking segment of the equities business, historically the main fuel of the retail business.

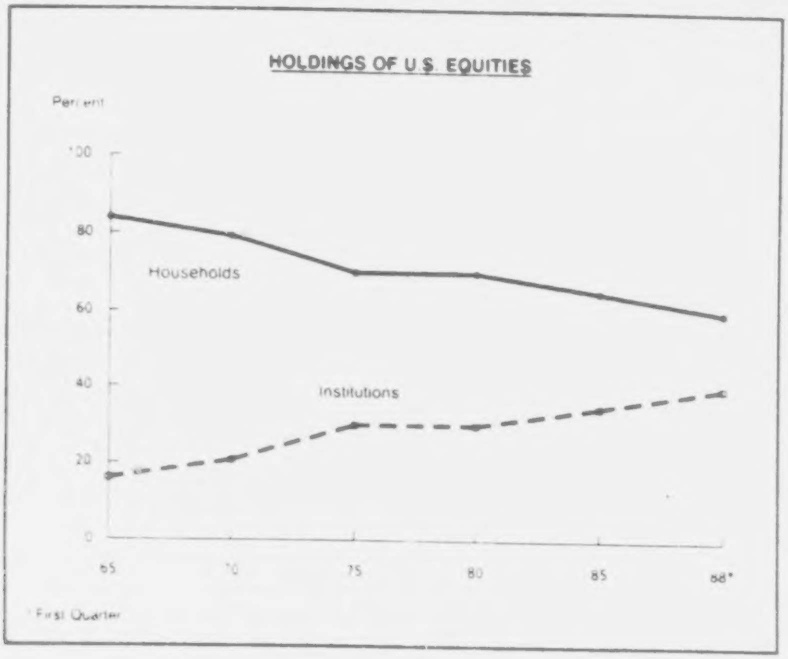
Table 4

HOLDINGS OF U.S. CORPORATE EQUITIES

(In Percent)

	1965	1970	1975	1980	1985	1988
Households	84.1	79.3	70.4	70.2	65.3	60.0
Institutions	15.9	20.7	29.6	29.8	34.7	40.0
(In $ Trillions)						
Households	0.6	0.7	0.6	1.1	1.7	1.8
Institutions	0.1	0.2	0.3	0.5	0.9	1.3

Note: Based on Federal Reserve Board's Flow of Funds data, excluding mutual funds. Figures are at market value, and 1988 data as of March 31.



Securities Industry Concentration

Another change affecting the industry, particularly smaller firms, is the increased concentration of the securities business in the hands of the larger firms. For the NYSE member firms which deal with the public (generally 400 of the industry's largest firms), the 10 largest capitalized firms (2.5% of the firms) generate 55% of the industry's revenues and control 60% of the industry's capital. Another 21% of the revenue and 17% of the capital is in the hands of the next 15-largest firms (4% of the firms), leaving less than a quarter of total revenues and capital for the remaining 350 to 375 (93%) NYSE firms.

How Have Smaller Firms Fared?

The question arises, if the industry financials are so weighted by the largest firms, what's been happening to the smaller firms? In past issues of Trends, sub-categories of the NYSE group were analyzed, i.e., National Full Line firms, Large Investment Banks, Regionals, Discounters, New York City-based regionals, etc. But the Regionals' group can also be sub-divided into Large, Medium and Small Regionals. To see how the smaller firms are faring, we will analyze this group of Small Regionals (see Appendix for a list of these firms).

These Small Regionals have revenues ranging from $2 million to $20 million, averaging around $10 million; have total capital averaging around $4 to $5 million and employ around 100 people each; clearly larger than many small firms, but their business mix is still typical of most small firms. For example, their business is mainly commission income, and their performance does reflect the same trends and forces affecting most small firms.

As Table 5 shows, the growth in revenues and expenses for Small Regional firms during the Eighties, at least through last year, has been strong. On an aggregate basis, most revenues and expenses showed a near linear growth from 1980 through the 1986-87 period, with the exception of 1984, a poor year for the securities industry. Over this period, total revenues were up over 60%, although falling about 20%, this year.

Expenses, unfortunately, grew much faster than revenues. Total expenses doubled from 1980 through last year. Compensation, the biggest expense item, also doubled. This year, based on first half results, cost control measures have reduced all expenses 23%, and compensation costs, 24%.

Trends in Revenue Sources

Commissions, the Small Regionals' main revenue source, is down a drastic 32% so far this year, matching 1985's level. We've previously seen how commissions have fallen to just 18% of total revenues for all NYSE firms. For Small Regionals, commissions were still half of all revenues in 1980 and 1987, but have ranged from just 40% to 45% of all revenues for most of the Eighties (Table 6).

Trading revenues, mainly from OTC market making and bond trading, will exceed last year's showing which was running below 1986's level even before the crash-impacted fourth quarter caused an additional $6 million loss.

Revenues from investments in firms' own accounts are running slightly ahead of last year but below the 1986 level. Underwriting revenues, meanwhile, increased during the bull equity years of the Eighties, but have now fallen back to the same aggregate levels before Rule 415's passage by the SEC. Further, margin interest revenues peaked for the Small Regionals in 1981, and have been gradually declining to an annualized low of $23 million this year. Conversely, interest expense also peaked in 1981 and declined to an annualized near-low of $29 million this year.

Revenues from the sale of mutual funds rose over 12-fold over the five years, 1981 to 1986, practically doubling each year, to a record $62 million (or 13% of revenues). This income source has now fallen to less than $22 million (on an annualized basis), back to 1984 levels or just one-third of their amount two years ago.

Table 5

NYSE SMALL REGIONALS' FINANCIALS

(In $ Millions)

Revenues	80	81	82	83	84	85	86	87	88*
Commissions	155.4	145.5	149.5	192.8	146.1	164.7	206.2	241.9	164.8
Trading	33.6	31.9	35.1	41.5	43.9	67.2	62.4	35.6	54.6
Investments	4.9	0.1	1.4	4.5	1.4	6.0	9.2	8.1	8.6
Underwriting	22.0	27.8	29.1	46.2	33.3	44.0	38.4	29.2	25.4
Margin Interest	41.1	63.7	47.0	41.1	42.7	32.1	28.0	27.0	23.2
Mutual Funds	4.5	5.4	9.6	16.5	18.9	33.5	61.9	48.0	21.8
Fees	9.6	10.5	11.5	13.3	15.4	20.1	23.5	23.8	24.6
Research	1.6	0.7	0.6	1.3	3.4	4.3	4.5	7.8	9.6
Commodities	1.4	0.9	0.9	1.1	0.9	1.1	3.5	3.6	4.0
Other Related	19.7	29.2	31.9	29.9	29.5	33.8	39.1	41.5	36.2
Other	5.4	7.3	6.9	7.0	10.0	8.6	12.0	18.8	13.8
Total Revenues	299.4	323.2	323.7	395.0	345.5	415.6	489.0	485.4	387.0
Expenses									
Compensation	147.2	126.6	163.5	210.3	185.4	222.0	270.7	290.2	221.0
Floor Costs	20.1	18.6	18.1	20.3	17.6	21.6	26.7	31.1	23.2
Communications	16.4	37.0	20.8	24.3	23.7	23.8	28.6	31.4	27.4
Occupancy/Equp.	11.0	29.2	14.5	17.6	19.7	20.3	25.7	27.5	26.4
Promotional	8.7	11.2	12.1	14.4	14.1	14.4	15.3	13.7	9.8
Interest	30.6	49.6	39.3	31.0	34.3	26.4	26.7	34.8	29.0
Error/Bad Debt	1.8	1.1	1.8	2.6	1.1	1.0	2.9	11.0	1.0
EDP Costs	5.2	6.2	6.4	7.6	7.6	8.3	10.2	12.0	11.2
Non-Recurring	1.6	1.0	1.3	1.4	0.3	0.9	0.5	0.3	0.2
Regulatory Fees	2.4	2.6	2.5	3.2	3.3	4.0	3.7	3.7	3.4
Other Expenses	13.9	15.6	16.8	21.8	21.4	25.5	37.7	44.0	31.0
Total Expenses	259.0	296.1	296.5	354.8	328.4	368.8	447.9	499.5	384.2
Net Income	40.4	27.1	27.2	40.2	17.1	46.8	41.1	(14.1)	2.8

*First half annualized.

Table 6

NYSE SMALL REGIONALS' FINANCIALS

(Percent of Revenues)

Revenues	80	81	82	83	84	85	86	87	88*
Commissions	51.9	45.0	46.2	48.8	42.3	39.6	42.2	49.8	42.6
Trading	11.2	9.9	10.8	10.5	12.7	16.2	12.8	7.3	14.1
Investments	1.6	0.0	0.4	1.1	0.4	1.4	1.9	1.7	2.2
Underwriting	7.3	8.6	9.0	11.7	9.6	10.6	7.9	6.0	6.6
Margin Interest	13.7	19.7	14.5	10.4	12.4	7.7	5.7	5.6	6.0
Mutual Funds	1.5	1.7	3.0	4.2	5.5	8.1	12.7	9.9	5.6
Fees	3.2	3.2	3.6	3.4	4.5	4.8	4.8	4.9	6.4
Research	0.5	0.2	0.2	0.3	1.0	1.0	0.9	1.6	2.5
Commodities	0.5	0.3	0.3	0.3	0.3	0.3	0.7	0.7	1.0
Other Related	6.6	9.0	9.9	7.6	8.5	8.1	8.0	8.5	9.4
Other	1.8	2.3	2.1	1.8	2.9	2.1	2.5	3.9	3.6
Total Revenues	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Expenses									
Compensation	49.2	39.2	50.5	53.2	53.7	53.4	55.4	59.8	57.1
Floor Costs	6.7	5.8	5.6	5.1	5.1	5.2	5.5	6.4	6.0
Communications	5.5	11.4	6.4	6.2	6.9	5.7	5.8	6.5	7.1
Occupancy Equp.	3.7	9.0	4.5	4.5	5.7	4.9	5.3	5.7	6.8
Promotional	2.9	3.5	3.7	3.6	4.1	3.5	3.1	2.8	2.5
Interest	10.2	15.3	12.1	7.8	9.9	6.4	5.5	7.2	7.5
Error Bad Debt	0.6	0.3	0.6	0.7	0.3	0.2	0.6	2.3	0.3
EDP Costs	1.7	1.9	2.0	1.9	2.2	2.0	2.1	2.5	2.9
Non-Recurring	0.5	0.3	0.4	0.4	0.1	0.2	0.1	0.1	0.1
Regulatory Fees	0.8	0.8	0.8	0.8	1.0	1.0	0.8	0.8	0.9
Other Expenses	4.6	4.8	5.2	5.5	6.2	6.1	7.7	9.1	8.0
Total Expenses	86.5	91.6	91.6	89.8	95.1	88.7	91.6	102.9	99.3
Net Income	13.5	8.4	8.4	10.2	4.9	11.3	8.4	(2.9)	0.7

*First half

Fees from account supervision mirrored the climb of mutual fund revenues as they reflect the amount of assets gathered in-house, partly from the sale of these packaged products. However, once these assets are being managed in-house they become more "crash resistant" in that they continue to generate management fees as long as there isn't a large net sell-off of the aggregate portfolios under management (or large net transfer out from management by these groups of firms). In fact, the fee income of around $24 million from this sector this year will match 1986 and 1987 levels. Moreover, it is now a larger contributor to total revenues than ever before (6.4%).

Compensation Costs -- Expense #1

Compensation expense doubled for the Small Regionals from 1980 through last year, outstripping these firms' revenue growth. At the beginning of the Eighties, just under half of all revenues went towards compensation but payroll costs, as mentioned, kept eating further and further into the revenue base. It steadily climbed to 60% of revenues last year and although absolute compensation expense has fallen 24% this year, it still is consuming over 57% of this year's much smaller revenue base.

This growth in compensation is mainly in the clerical area. Registered representative compensation, while growing over the years, has held even at just under a quarter of all revenues. Clerical compensation, however doubled from 1980 through 1987 and inched up as a proportion of total revenues, now 18%, second only to RR compensation's 23%.

Total expenses doubled from 1980 through last year to a record $500 million for the Small Regionals but fell 23% so far this year. As for the pre-tax bottom line, the best profit margin achieved in the Eighties was 13.5% way back in 1980. In the very good bull years of 1983 and 1985, this group managed only a 10% to 11% return and in 1981, 1982 and 1986, also good years, the margin was only 8.4%. Last year, a tough time for all types of firms in the securities industry, these firms lost money but they have managed to climb back into the black in 1988's first half.

What About Profits?

How does this group of small firms compare with other NYSE groups when it comes to profitability? Table 7 highlights the profit margins over the Eighties for all NYSE firms and other sub-categories, including Medium, Large and all Regionals. In almost every case, the Small Regionals underperformed their larger regional counterparts as well as every other firm category except the National Full Line Firms.

Table 7

PRE-TAX PROFIT MARGINS

(In Percent)

Firm Category	80	81	82	83	84	85	86	87	88*
National Full Line	10.9	6.9	8.8	8.6	(0.9)	5.6	6.9	(0.9)	0.3
Large Investment Banks	17.7	15.4	17.4	16.7	11.4	14.6	13.5	4.7	10.4
New York City Based	14.8	12.6	14.0	18.3	8.9	12.3	16.1	2.2	11.5
NYSE Discounters	17.5	12.2	13.6	14.0	0.3	8.9	15.7	8.6	3.4
Regionals	14.7	11.2	11.1	12.6	2.6	9.4	11.0	5.5	3.4
Large Regionals	15.6	11.7	10.6	12.5	1.8	7.6	11.9	7.2	4.9
Medium Regionals	13.6	11.1	13.0	13.5	3.1	11.6	10.0	4.7	1.1
Small Regionals	**13.5**	**8.4**	**8.4**	**10.2**	**4.9**	**11.3**	**8.4**	**(2.9)**	**0.7**
Total Industry	14.1	10.8	13.1	12.9	5.2	10.7	11.0	2.3	6.7

*First Half.

The previous analysis highlights some basic shifts in the relative importance of certain income sources and expenses over nearly a decade. But the most dramatic changes began last year.

Moving from Bull to Bear

Last year, the Small Regionals had only one profitable quarter as a group. This, not surprisingly was in the first quarter while the bull was still roaring. So far this year, these firms have not been able to collectively earn anywhere near $1 million per quarter nor muster even a 1% profit margin before taxes! Table 8 shows what has happened to some key financials of Small Regionals since the first quarter of last year. Revenues were $140 million and fell to around $125 million in the second and third quarters or down more than 10%. In the fourth quarter and in each of this year's first two quarters, revenues fell to levels just below $100 million, or down another 20%.

Commissions fell from around $65 million in each of 1987's first two quarters to $58 million in the last two, or down more than 10%. This year's first two quarters showed commissions of only $41 million.

Cost Cutting -- a Survival Instinct

Though the previous figures indicate very bleak times for smaller firms, it also shows that these firms have been able to quickly adapt their cost structures to survive in these tough times. On the anemic level of revenues this year, which are even worse than the crash-impacted fourth quarter last year, these firms did manage to contain expenses, especially the all important compensation line, so that their bottom line is again being penned in black ink. These reductions were not unpainful -- in 12 months, Small Regionals reduced their workforce by 24% or a loss of nearly 1,200 jobs.

Table 8

SMALL REGIONALS' QUARTERLY PERFORMANCE

(In $ Millions)

	87:Q1	87:Q2	87:Q3	87:Q4	88:Q1	88:Q2
Revenues	138.5	125.5	122.0	99.4	98.5	95.0
Commissions	62.5	63.6	58.8	57.0	40.7	41.7
Expenses	129.5	127.9	122.1	119.8	97.7	94.4
Compensation	79.0	76.9	71.3	63.0	56.4	54.1
RR Comp.	31.4	32.4	29.3	25.4	24.6	19.8
Clerical	21.7	22.4	22.5	19.7	16.9	17.1
Profits	8.9	(2.5)	(0.1)	(20.4)	0.8	0.6

Employment

	87:Q1	87:Q2	87:Q3	87:Q4	88:Q1	88:Q2
Producers	2,071	2,214	2,101	2,057	1,910	1,577
Non-Producer	2,645	2,593	2,697	2,252	2,127	2,079
Total	4,716	4,807	4,798	4,309	4,037	3,656

Retail RR Production and Earnings

For small firms, financial health is very dependent on how retail RR production is doing. Unfortunately, here again, the post-crash scenario has been gloomy. According to one of many compensation studies produced by SIA, Report on Production and Earnings of RRs, the growth of gross production of retail RRs throughout the Eighties for all firms, including small firms, was extremely strong through 1986 (also true for institutional RRs). However, production leveled off last year, not in small part due to the final quarter's market crash.

A follow-up survey for the post-crash environment (November 1987 through April 1988, annualized), shows that retail production turned on a dime (Table 9), cascading to levels not seen for years.

For this survey's small firms (those with fewer than 50 retail RRs), gross production of retail RRs rose $15,000 in 1986 and another $20,000 last year, to a 1987 average of $199,000. However, in the six months since the crash, this production was down 28%, or more than $56,000 to a level of just $142,000 on an annualized basis (Table 9). This was a much steeper drop than the National firms or the industry average.

Comparing gross production to the average earnings of retail RRs for all firms, we see that the drop of about $56,000 per RR in production equally ate into the pockets of the RRs and the firm to the tune of about $28,000 each. However, a similar drop of $57,000 in small firms' retail production was not equally shared by the producer and the firm. The small firms' producer saw his earnings fall $22,000 while the firms' net production dropped $34,000.

Table 9

AVERAGE RETAIL RR PRODUCTION

(In $ Thousands)

	1985	1986	1987	11/87 4/88*	% Change 87-88
Large National Firms	214.1	250.9	258.1	197.0	(23.7)
Small - Up to 50 RRs	165.5	179.9	199.0	142.4	(28.4)
All Firms	206.0	243.8	246.5	190.8	(22.6)

AVERAGE RETAIL RR EARNINGS

	1985	1986	1987	11/87 4/88*	% Change 87-88
Large National Firms	81.8	99.4	97.4	67.1	(31.1)
Small - Up to 50 RRs	69.3	82.5	78.8	56.6	(28.2)
All Firms	79.6	97.1	94.0	66.2	(29.6)

AVERAGE NET RETAIL INCOME

	1985	1986	1987	11/87 4/88*	% Change 87-88
Large National Firms	132.2	151.5	160.7	129.9	(19.2)
Small - Up to 50 RRs	96.2	97.4	120.2	85.8	(28.6)
All Firms	126.4	146.7	152.5	124.6	(18.3)

*Annualized

Source: SIA's "Report on Production & Earnings of RRs"

However, on a percentage basis, the reverse is true. Small firms' retail RR's gross production, earnings and the firm's net production all fell an equal 28%. Meanwhile, for all firms, the retail RR's production fell 23%, his earnings fell a larger 30%, leaving the firm with a net production falling a smaller 18%.

Surviving in a Down Market

What else is needed to survive these periods? We've seen that the assets which were gathered in-house during the bull market, despite anemic additions on top of attritions since the crash, are still generating fee income, projected to reach a record $25 million for Small Regionals this year. Further emphasis on fee income and asset gathering is a must for such firms.

Small Regionals have also been able to maintain over $20 million in OTC market making profits since 1985 -- double the levels of the early Eighties. Since many of the major New York houses, as well as other brokerages, having curtailed their inventories of these securities as well as the spectrum of stocks they once covered since the crash, small firms' specialty and regional coverage in this area also provides opportunities to continue, if not grow, this part of the business.

Bond trading for Small Regionals this year accounts for double the share of revenues it did at the start of the Eighties. While this year's profits from debt trading is expected to fall short of 1985's record level, it still should be emphasized as a profit center especially with today's individual investor's appetite for safe fixed-income products.

In the same vein, mutual fund products, while horrendously off on the equity side, have become such a large contributor to the total revenue picture (and the fee picture also) in recent years that emphasizing the fixed-income products available is a must to keep this revenue source alive in these markets.

Underwriting revenues tie into this same picture. On the debt side, underwritten CDs have been a growing item in this market and the fixed-income closed end funds have been the one equity product hit of 1988. Over three-quarters of the $17.4 billion in IPOs underwritten in this year's first eight months came from these closed end funds. In fact, the $13.3 billion underwritten through August already far exceeds last year's record $9.8 billion. Further, these funds didn't even come alive until 1985 and then shot from nowhere to over $4 billion in 1986, so they are still very young in the product life cycle.

Municipal underwritings, after falling more than 25% annually since tax reform changes took place at the end of 1985, appear to be holding steady at last year's pace. With investors' new-found, or at least only remaining, love for fixed-income products this year, munis appear another revenue hope for small firms.

As far as the bread and butter business line of small firms -- agency equity commissions -- the very real problems this year have been felt before. As we've seen earlier, the drop-offs in volume and business on the exchanges are still only back to pre-1987 levels, a good base to start with for future growth. And in the securities business, ever cyclical, there is always future growth...it's just a question of the timing.

It is this timing which is the big question. So far this year, the value of trading on the NYSE is down a dramatic 26% (SIA's Investor Activity Report). With similar declines in other markets, including the OTC market, and other business lines for the past 12 months, many smaller firms have been financially hurt, and some forced to merge or close shop.

The vast majority, however, have quickly moved to reduce costs to levels more in line with reduced revenues. If the slowdown is not too protracted, small firms' continued cost control measures can position them well for the inevitable up cycle.

George R. Monahan
Director of Industry Studies

APPENDIX

NYSE Member Small Regional Firms*

Adams, Harkness & Hill, Inc.
Baker, Watts & Co.
Bartlett & Co.
Branch, Cabell & Co.
Butler, Wick & Co., Inc.
Cable, Howse & Ragen
Christopher (B.C.) Securities Co.
Davenport & Co. of Virginia, Inc.
Equitable Securities Corporation
Ferris & Company Incorporated
Folger Nolan Fleming Douglas, Inc.
Gradison & Company Incorporated
Hanifen, Imhoff, Inc.
Hazlett, Burt & Watson
Howe, Barnes & Johnson, Inc.
Hummer (Wayne) & Co.
Illinois Company Incorporated (The)
Investment Corp. of Virginia
JW Charles-Bush Securities, Inc.
Midland Doherty & Inc.
Milwaukee Company (The)
Noyes (David A.) & Company
Parker/Hunter Incorporated
Reaves (W.H.) & Co., Inc.
Roulston Research Corp.
Rowland (R.) & Co., Incorporated
Seidler AMDEC Securities, Inc.
Smith, Hague & Co., Inc.
Smith, Moore & Co.
Sterne, Agee & Leach, Inc.
Swift (Henry F.) & Co.
Weber, Hall, Sale & Associates, Inc.
Wilshire Associates
Young, Smith & Peacock, Inc.

*As of June 30, 1988.

PRICES
(END OF MONTH)

	OCT 1988	OCT 1987	% CHAN OCT 1988-1987
DOW JONES INDUSTRIALS	2148.65	1993.53	7.78%
STANDARD & POOR'S 500	278.97	251.79	10.79%
NYSE COMPOSITE	156.94	140.80	11.46%
AMEX MARKET VALUE INDEX	300.95	260.36	15.59%
VALUE LINE COMPOSITE	234.41	201.10	16.56%
NASDAQ COMPOSITE	382.46	323.30	18.30%

(MONTHLY AVERAGES)

	JUL 1988	JUL 1987	BASIS POINT CHG 1988-1987
BOND BUYER INDEX (20 BOND)	7.76%	7.72%	4
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	9.96	9.42	54
Baa CORPORATE	11.11	10.61	50
RATIO Aaa CORPS. TO Baa CORPS.	0.90	0.89	1

VOLUME

	SEPT 1988	YTD 1988	SEPT 1987	YTD 1987	% CHGN YTD 1988 1987
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	145.7	167.3	177.3	181.1	-7.6%
AMEX (MILS.)*	8.4	10.1	12.4	13.7	-26.2%
NASDAQ (MILS.)*	111.8	125.1	148.3	149.9	-16.6%
REGIONAL EXCHANGE (MILS.)*	21.5	23.1	25.6	27.5	-15.9%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$101,435	$1,044,356	$163,895	$1,426,618	-26.8%
AMEX (MILS.)	2,463	25,321	4,222	40,585	-37.6%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	6,759	64,282	9,481	96,452	-33.4%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	14,805	133,588	15,465	157,856	-15.4%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	54.7%	53.0%	49.8%	51.3%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	8,841	81,063	17,784	146,633	-44.7%
AMEX OPTIONS	3,354	28,059	4,733	41,165	-31.8%
COMMODITY	20,185	184,477	22,407	171,520	7.6%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

UNDERWRITING

	OCTOBER 1988	OCTOBER 1987	% Change 1988-1987
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$21,465.8	$15,131.0	41.9%
Common Stock	$1,619.1	$703.7	130.1%
# of Common Stock Issues	30	55	-45.5%
Preferred Stock	$727.5	$173.9	318.3%
# of Preferred Stock Issues	10	2	400.0%
Corporate Debt	$19,119.3	$14,253.4	34.1%
# of Corporate Debt Issues	213	142	50.0%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$7,619.7	$5,445.2	39.9%
# of Issues	123	175	-29.7%
Competitive	$2,864.3	$2,053.4	39.5%
# of Issues	116	80	45.0%

Source: IDD Information Services

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
"The Debt Binge"	A series of articles pulled together into a Special Report on debt financing. Concludes: U. S. Corporations are operating with more debt and a higher level of risk than at any time in recent memory. This can bring lavish economic rewards, but it can also end in disaster. The need for government and business to work together has never been greater. Business depends on government for sound economic policies, and government depends on business to compete effectively worldwide.	Business Week 11/7/88
"Sources of IRA Saving"	This paper, which reviews the period 1982-86, shows that there is strong evidence that IRA saving does represent new savings. In addition, evidence is provided that even those taxpayers who did enroll in IRAs did not take full advantage of its provisions. This result highlights the role of public information in affecting savings behavior. Thirdly, the paper shows that IRAs were not particularly progressive and suggest that for income levels of less than $40,000, a general saving incentive for interest and dividend income might have been more equitable. However, authors point out that 1) it is not clear that a general saving incentive system would have been as successful as an IRA in encouraging new savings and 2) taxpayers need immediate gratification to nudge them toward adequate retirement saving.	D. Feenberg and J. Skinner National Bureau of Economic Research 10/88
"Foreign Banks Expand U. S. Base"	Exploiting the keen interest in cross-border mergers and acquisition, foreign merchant banks and boutiques are giving U. S. investment banks and boutiques a run for the globally attuned corporate client's money and loyalty. Article also profiles several foreign merchant banks and their strategies.	Pensions & Investment Age 11/14/88

Item	Description	Source
"Fannie Mae Flexes its Muscles"	After almost sinking in the early 1980's under the weight of mismatched debt and investments and a wave of defaults in home-loan markets in certain states, Fannie Mae at age 50 is now on a steady course with $103 billion of assets and a revenue stream of $263 million. Article reviews turbulence of the early 1980s, steps to regain health and plans for the future for this 100% publicly owned company which, in effect, is responsible for the financing of the homes of some 8 million Americans.	Institutional Investor November 1988
"Yes, you can Manage Long Term"	Executives complain that Wall Street won't let them look past the here and now. Article disputes this argument by looking at several companies, their managers, and strategies that have found favor with investors. Conclusion: The stock market tends to get values right and evaluate managers for what they are worth.	Fortune 11/21/88
"Repackaging Junk"	Using "securitization," Street firms have devised a way to turn junk bonds into high grade bonds. Although only a few deals have been put together, industry officials think the potential market is huge -- $30-$50 billion in size by the mid-1990s. Article reviews pros and cons of securitizing junk bonds.	Investment Dealers' Digest 11/28/88
"What Ails Stock?"	What has spooked investors all over the world? Editorial comment briefly reviews experience since the crash and concludes that we're in for a prolonged period of adjustment--in people's attitudes, public policies and perhaps more than anything, in relative investment values.	Barron's 11/21/88

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SIA SECURITIES INDUSTRY ASSOCIATION

TRENDS

An Analysis of Emerging Trends in the Securities Industry

Produced by the SIA Research Department

Vol. XV, No. 1

January 6, 1989

THE SUPPLY OF AND DEMAND FOR SECURITIES

AN OVERVIEW OF THE 1980s

Highlights

1. The stock market's slump has persisted since October 1987 despite a sharp reduction in the supply of equities outstanding and amidst the second longest expansion in U.S. postwar history. This paper reviews the broad trends in the supply of and demand for securities by investor sector in order to add insight to the current state of our capital markets.

2. In the period 1980 through the first nine months of 1988, there was a sharp shrinkage in the amount of equities outstanding -- $275.4 billion, and an explosion of debt issuance -- $849.4 billion of corporate bonds and $2.2 trillion of government securities. Thus, while the value of equities just about equaled the value of government and corporate debt outstanding in 1980, equities outstanding measured only 69% of government and corporate debt by 9/30/88.

3. Despite the increased supply of fixed income securities, particularly after 1983, nominal interest rates trended downward after 1982 as monetary policy eased, except for a surge in 1984. Nevertheless, the increased supply of bonds kept real interest rates relatively high, attracting funds to fixed income products.

4. Private pension funds, traditionally viewed as the largest buyers of equity, shifted to a net selling position well before the 1987 crash. Net sellers of $8-$9 billion of equities annually in 1985 and 1986, these investors sold a net of $28 billion in 1987 and divested equities at about the same pace in 1988.

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5. Mutual funds, also considered large purchasers of equities, were actually not significant buyers in the 1980s until 1986 and 1987, when net purchases averaged over $20 billion annually. These investors were selling at an annualized pace of $18 billion in 1988.

6. As a whole, based on annualized data, institutional investors were net sellers of equities of almost $20 billion in 1988 for the first time in the 1980s. In contrast, institutional investors have steadily increased their allocation of funds to credit market instruments over the 1980s. Annualized data show record purchases of corporate bonds in 1988, $124.5 billion.

7. Unless the traditional buyers of equities return to the market or interest rates decline sharply, the price of equities will not reflect the improved profit picture except for those companies that are takeover candidates.

INTRODUCTION

Since October 1987, the stock market has failed to shake lower volume and prices. The stock market's slump has persisted despite a sharp reduction in the supply of equities outstanding and amidst the second longest expansion in U.S. postwar history. The expansion has lasted 74 months, with GNP growing by about 30% through December 1988. The longest post World War II expansion started in February 1961 and lasted through December 1969, or 107 months. During that time, real GNP increased 46.5% compared to about 30% through 1988 for the current expansion. In other words, in economic terms, there's a ways to go to break the record.

In this overview, we will rely on a Flow of Funds analysis in attempting to explain broad trends leading to the current state of our capital markets. Such analysis shows how investors have changed their savings and investment patterns in the 1980s while broad new policies on deregulation, price competition, free trade and lower marginal tax rates, have been put in place. Over the same time, there have been occasional episodes of marked uncertainty as stalemates developed between the Administration and Congress over these policies and other issues, particularly the budget. We will also look at how issuers of securities changed over the 1980s.

THE SUPPLY OF SECURITIES

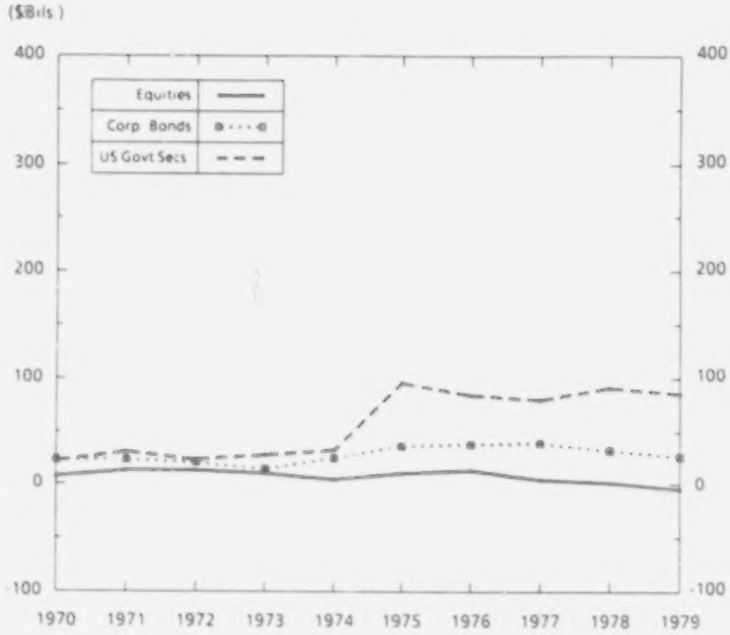
The withdrawal of equities from the marketplace has continued for five consecutive years, starting in 1984 when $65 billion was withdrawn. These withdrawals or retirements resulted from acquisitions, share repurchases and leveraged buyouts. In contrast, corporate bond issuance has risen steadily, jumping dramatically after 1983. Table 1 shows the net value of equities withdrawn from the market since 1980, a total of $275 billion, the net issuance of corporate bonds, about $849 billion, and the net issuance of federal government bonds, $2.2 trillion.

Table 1

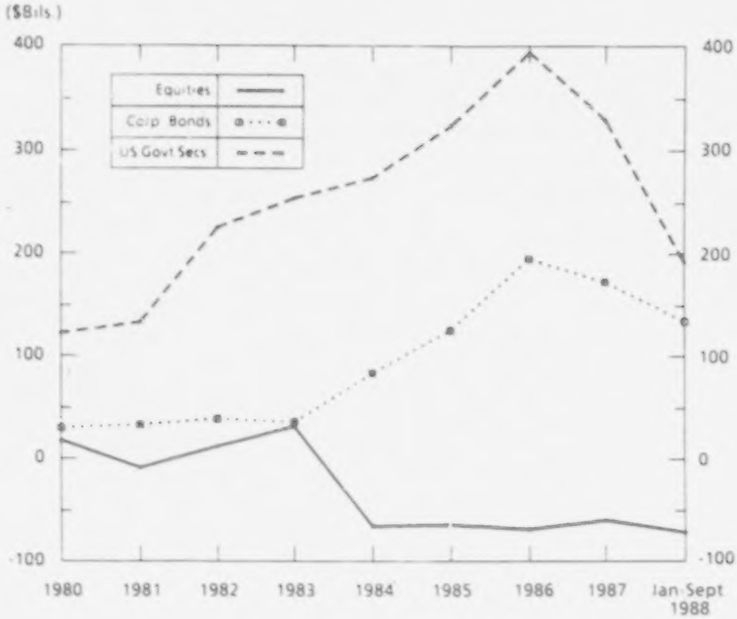
The Supply of Securities
($ Billions)

	Net Equity Retirements	Net Issuance of Corporate Bonds	Net Issuance of U. S. Governments
9 mos. '88	$(70.9)	$134.0	$191.8
1987	(59.0)	173.8	330.4
1986	(68.0)	195.2	393.5
1985	(64.3)	125.4	324.2
1984	(65.3)	83.0	273.8
1983	30.8	36.4	254.4
1982	12.4	38.4	225.9
1981	(8.5)	32.7	133.0
1980	17.4	30.5	122.9
Total	$(275.4)	$849.4	$2,249.9

Source: Flow of Funds Accounts, Third Quarter 1988 with Annual Revisions,
Federal Reserve Board



NET ISSUANCE
1970s



NET ISSUANCE
1980s

As discussed extensively in the financial press, the government deficit ballooned in the 1980s. The deficit passed the $200 billion mark in 1982 and more or less deteriorated over the next few years until subsiding to $150 billion in 1987. These growing deficits are reflected in Table 1, which shows the annual borrowing through U. S. government securities. Until 1986, the value issued increased every year and, although there was slight improvement in 1987, the deficit and other factors still added well over $300 billion to the public debt. Thus, Federal government securities as well as corporate bonds contributed to a dramatic increase in the supply of fixed income securities available in the marketplace.

The value of equity outstanding in the U. S. was almost equal to government and corporate debt outstanding at year-end 1980, about $1.6 trillion each. Subsequently, the increase in total government and corporate bond debt outpaced the increase in equity outstanding. U. S. Treasuries, the largest component of government debt, escalated from $737.8 billion at year-end 1980 to over $2 trillion by September 1988. Corporate bond debt jumped from almost $500 billion at year-end 1980 to $1.3 trillion by September 1988. Thus, the balance tilted towards greater debt. At the end of September 1988, equities outstanding measured about 69% of government and corporate bond debt. Looked at through another perspective, since the end of 1980, U. S. equities outstanding have increased in value by about 96%, government debt by 176%, and corporate bonds by 166%.

Based on the supply of fixed income securities alone and ignoring the demand for these instruments, we would expect that interest rates would rise because of the sharp increase in fixed income securities, both public and private, issued into the marketplace. Interest rates are simply the cost of obtaining funds for a period of time. Thus, if more borrowers seek funds, the cost of obtaining funds or interest rates should rise, other things constant.

Clearly, this explanation is an oversimplification of only one of the factors affecting interest rates. Although the supply of fixed income instruments impacts the level of interest rates, it is also true that interest rates affect the supply of bonds. The Federal Reserve's monetary policy affects the cost of money or interest rates, which, in turn, influences the private sector's demand for money and its willingness to supply funds. Thus, although the supply of fixed income instruments increased noticeably after 1983, nominal interest rates trended downward after 1982 except for a temporary surge in 1984. That is, the Federal Reserve eased monetary policy after the inflation threat was erased from the economy.

Nevertheless, the increased supply of bonds has been reflected, in our opinion, in terms of real, if not nominal, interest rates. Real interest rates (interest rates less inflation) did not actually "improve" or decline until late 1986 and 1987. Hence, the supply of fixed income securities affected interest rates by keeping real rates higher than they otherwise would be despite a literally flat annual change in the CPI from 1982-1985.

In the case of U. S. equities, $275 billion was retired by one method or another from 1980 through the first nine months of 1988. This was equal to over 7% of the value of equities outstanding in the U. S. just before the crash in October 1987 and equal to 9% of the value of equities at September 30, 1988, about $3.1 trillion. By itself, the dwindling supply of equities in the 1980s would lead to higher equity prices, other things constant.

Indeed, the stock market boomed from mid-1982 through October 1987 (the value of equities increased from $1.7 trillion at year-end 1982 to $3.8 trillion at 9/30/87). Since the crash, however, the market has languished with P/E ratios equal more or less to the historic norm of 12-13 and stock prices 20% or more below their 1987 peaks. The failure of the market to stage a strong recovery is surprising, given a diminishing supply of equities, an expanding economy and a 30% gain in corporate profits projected for 1988.

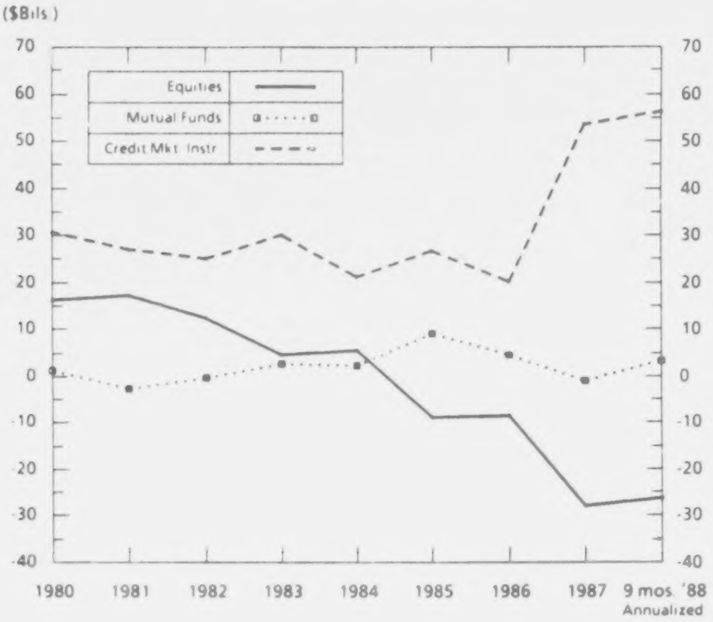
Trends in the economy alone cannot explain completely the lackluster stock market. However, attractive nominal and real interest rates serve as a magnet for attracting investment to fixed income securities rather than stock. It is possible that this factor, along with shifts in investment patterns by investor sectors, will shed light on why equity prices soared as they did until October 1987 and have slumbered ever since. An analysis of changing patterns of investment by different sectors should provide valuable insight into explaining today's capital markets.

THE DEMAND FOR SECURITIES

Private Pension Funds

The 1980s saw a definite shift in the investment pattern of private pension funds. Buyers of about $15 billion of equities annually from 1980-1982, these investors swung to net sellers well before the 1987 crash, making net sales of between $8-$9 billion of stock annually in 1985-86. In 1987, private pension funds sold a net of $28 billion of equity, and in 1988 they are selling at a pace that almost matches the 1987 level. Surprisingly, similar to the household sector (households, personal trusts, and non-profit organizations), they started to institutionalize their equity purchases in 1983. Even while selling equities directly in 1985 and 1986, these funds purchased $9 billion and $5 billion of mutual fund equity shares in 1985 and 1986, respectively. Moreover, during the first nine months of 1988, while still selling large amounts of equity directly, pension funds were "nibbling" at mutual fund equity shares.

NET ACQUISITIONS BY PENSION FUNDS



Private pension funds acquired between $20-30 billion annually of credit market instruments from 1980 through 1986. Acquisition of these instruments was stepped up dramatically in 1987 and purchases have remained at the higher plateau in the first nine months of 1988. Surprisingly, there has been only a modest increase in purchases of government securities despite the well reported "flight to quality" theme since the stock market crash. Recent acquisitions of government securities by pension funds are in line with that of the early 1980s. However, acquisition of corporate and foreign bonds has accelerated notably in 1987 and during the first nine months 1988, running at a rate 3 times greater than that in the 1983-1985 period. In addition, there has been a surge of interest in time deposits since 1986, which at $16.6 billion for 1988 annualized would be at the peak for the 1980-88 period.

In sum, the major surprise in a review of the investment preference of private pension funds in the 1980s was the swing out of direct equity investments years before the crash, at a time when the market was steadily rising. Traditionally viewed as the largest net buyer of stock in the U. S., these funds started cutting back on such purchases after 1982. Their net selling in 1985 and 1986 was not consistent with the bull market trend, although equity mutual funds came into vogue with these investors at that time. Nevertheless, the large equity sales by pension funds in 1987 and through the first nine months of 1988 significantly weakened the demand for equities. Apparently, corporate bonds have been perceived as a way of obtaining double digit returns with relatively limited risk (the threat of "event risk" became a common theme after the 2Q88).

State & Local Government Retirement Funds

State and local government retirement funds reduced their purchases of corporate equities by 75% in the 4Q87 and increased their allocation of funds to credit market instruments. After averaging $8.3 billion in the first three quarters, equity purchases by these investors dropped to $1.6 billion in 4Q87. In comparison, credit market purchases, which were at a $3.8 billion average pace in the first three quarters, increased to $13.2 billion. In the first nine months of 1988, these investors returned to the equity market but with a distinctly cautious stance. Annualized 1988 net equity acquisitions were only $19.2 billion, compared with $26.4 billion in 1987.

Credit market instruments are back in favor with these investors, particularly corporate bonds. On an annualized basis, these investors are acquiring $42.5 billion of credit instruments in 1988 compared with $26.3 billion in 1987. Of note, at $28.4 billion annualized, net purchases of corporate bonds compare with the previous high of $11.5 billion in 1984. On the other hand, the acquisition of government securities annualized would be only $13.7 billion, the lowest amount since $12.3 billion in 1985.

In general, with the exception of $20.0 billion of net acquisitions in 1983, these investors did not show a "big" interest in equities until 1985. Net purchases in 1985-1987 were about $26 billion annually, or about half of total net acquisitions of financial assets. In contrast, in the early 1980s, over three-fourths of net acquisitions were credit market instruments, with a strong preference for government securities.

Thus, the investment behavior of these funds sheds little light on the mediocre performance of the stock market. State and local retirement funds have been active and relatively large equity buyers since 1985. Despite a modest waning in net purchases in 1988 (annualized), these investors appear to be raising the proportion of their total financial assets allocated to equities and this strategy has buoyed the stock market somewhat.

Life Insurance Companies

Life insurance companies were net purchasers of $1.4 billion of equities in the 4Q87 in contrast to net sellers of $0.6 billion in 3Q87. In terms of credit market instruments, these investors were purchasers of $21.7 billion compared with $28.1 billion in the 3Q. In general, the crash appears to have had little impact on their investment pattern. Moreover, their net acquisitions of equities ran at a $3 billion annualized rate during the first nine months of 1988, a level not strikingly different than their annual purchases during the 1980s.

Life insurance companies' acquisitions of financial assets grew steadily from 1980, reaching a peak in 1986 before probably increasing again in 1988. However, most of the time, purchases were directed to credit market instruments. Until 1984, life insurance companies split their allocation to credit market instruments almost equally between government securities and corporate bonds. After 1984, acquisitions of corporate bonds shot past that of government securities, becoming particularly heavy in 1987 and the first nine months of 1988. We believe that these investors acquired lower grade instruments in seeking to retain double-digit yields.

Credit market instruments, especially corporate bonds, are the traditional preference of these investors. In 1984, government securities comprised 43% of their purchases of credit market instruments. This percentage dropped to 30% in 1985; 21% in 1986; and less than 6% in 1987. Annualized nine months 1988 data show government securities rising modestly to 16% of credit market investment.

Other Insurance Companies

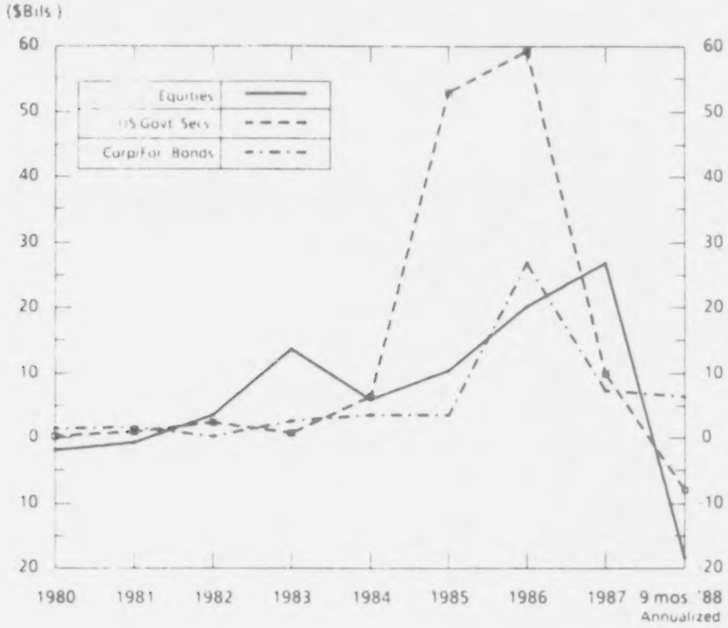
Similar to the larger category of life insurance companies, the investment pattern by these institutions remained unchanged during 4Q87 and first nine months of 1988. Over the 1980-87 period, these investors showed minimal interest in equities, making net acquisitions annually of $2-$3 billion in 1980-83 and net divestitures of $2-4 billion annually in 1984-86. Annualized nine months 1988 data shows a pickup in equity acquisitions to $3.0 billion compared with $1.5 billion in 1987.

Open-End Investment Funds

After being almost deserted by investors in the early 1980s, mutual funds enjoyed a burst of popularity which made this group among the largest acquirers of financial assets in the mid-1980s. Mutual funds acquired less than $25 billion of financial assets annually prior to 1985 but, with their return to favor, annual net purchases by these funds jumped to $81 billion in 1985 and almost $146 billion in 1986. Financial assets acquired by this group, however, plummeted to $53 billion in 1987 and will literally disappear, on an annualized basis, in 1988.

Contrary to common perceptions, most mutual fund purchases of financial assets are in credit market instruments. Only in 1986 and early 1987 did mutual funds' acquisitions of equities approach over $20 billion annually. In effect, the "bloom time" for mutual funds was 1985 - 1H87. By acquiring over $20 billion of equities in 1986 and almost $30 billion during the first three quarters of 1987, mutual funds boosted the demand for equities and stock prices significantly. Mutual funds swung to net sellers of equities during the 4Q87 and this pattern continued at an annualized $18 billion clip during the first nine months of 1988.

NET ACQUISITIONS BY OPEN-END INVESTMENT COS. (MUTUAL FUNDS)



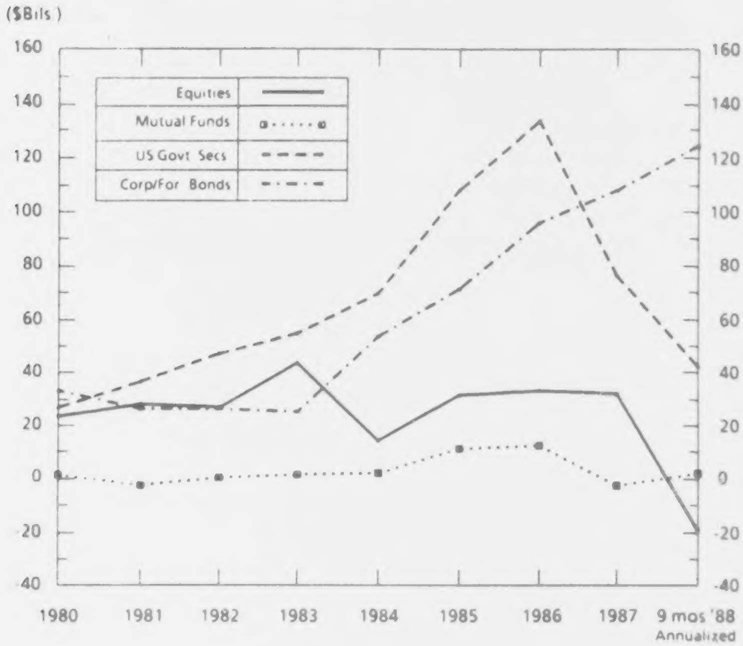
It is not well known that mutual funds were important buyers of government securities in 1985 and 1986, acquiring almost $53 billion and $60 billion, respectively. Recently, with the creation of many high-yield funds, mutual funds have become important buyers of corporate bonds. They purchased almost $27 billion of corporate bonds in 1986. Thus, open-end mutual funds were important factors to the U. S. capital markets in the mid-1980s. Their growth helped lower interest rates and added to the demand for equities while the supply was contracting.

All Institutions

Over the 1980s, the acquisition of financial assets by institutional investors (those covered in the preceding sections) rose dramatically as funds under management by these investors grew. Total purchases of financial assets increased from $132.0 billion in 1980 to a peak of $378.1 billion in 1986 before waning to $272.1 billion in 1987. Annualized first nine months data put acquisitions at $258.9 billion in 1988.

From 1980 to 1984, purchases of equities by these investors bounced from an average of over $26 billion in the first three years of the period, to a peak of $43.7 billion in 1983, and to a trough of $14.6 billion in 1984. From 1985-1987, institutional investors were net acquirers of over $30 billion of equities annually, giving a significant boost to equity prices as the supply of stock began to wane sharply.

NET ACQUISITIONS BY ALL INSTITUTIONS



Institutional investors' appetite for credit market instruments grew steadily from 1980 to a peak of $305 billion in 1986. Net acquisitions of government issues doubled from 1980 to 1983, and again from 1983 to 1985. After a hefty increase in 1986, institutional purchases of governments waned in 1987. Institutional investors' taste for corporate bonds heated up in 1984 and continued strong through the first nine months of 1988. Indeed, net acquisition of corporate bonds is now at a pace 1.75X the rate of 1985 which, in turn, was almost three times higher than 1983.

Summing up institutional investment behavior, these investors increased their holdings of financial assets steadily from 1980 until 1987. Importantly, even this sector's main buyer of equities, mutual funds, acquired more fixed income instruments than equities. Even compared to the peak in 1983 for institutional net purchases of equities, acquisition of credit market instruments by institutions has always been higher. In 1988, with the largest traditional institutional purchasers of equities -- private pension funds and mutual funds -- deserting this market, institutional investors are selling $19.4 billion of stock.

Foreign Investors

Foreign investors' interest in U. S. equities came into its own in the early 1980s and gathered momentum in 1986 and 1987 -- until the fourth quarter. Foreign investors were accumulating U. S. equities at a record-setting pace in the first three quarters of 1987 -- with $23 billion already breaking 1986's record of $17.8 billion. During 4Q87, foreign investors turned homeward bound to the tune of net sales of $7.8 billion of U. S. equities. And so far, they haven't seen much reason to come back. Net purchases totalled a modest $1.3 billion through the first nine months of 1988. Nevertheless, these investors have kept the same relative equity proportion of their total U. S. financial asset holdings over the 1980s -- about 16%. Still, total foreign holdings of U. S. financial asset holdings spurted 208% from 1981 to 3Q88.

While foreign investors kept basically the same equity allocation over time, there was a distinct shift in fixed income allocation. Government securities were the mainstay of foreign investment in the early 1980s, comprising 38% of total financial asset holdings in 1981. That proportion ebbed to 30% as of the 3Q88, as funds appear to have been shifted to corporate bonds which grew in relative proportion from 8% in 1981 to 14% by 3Q88.

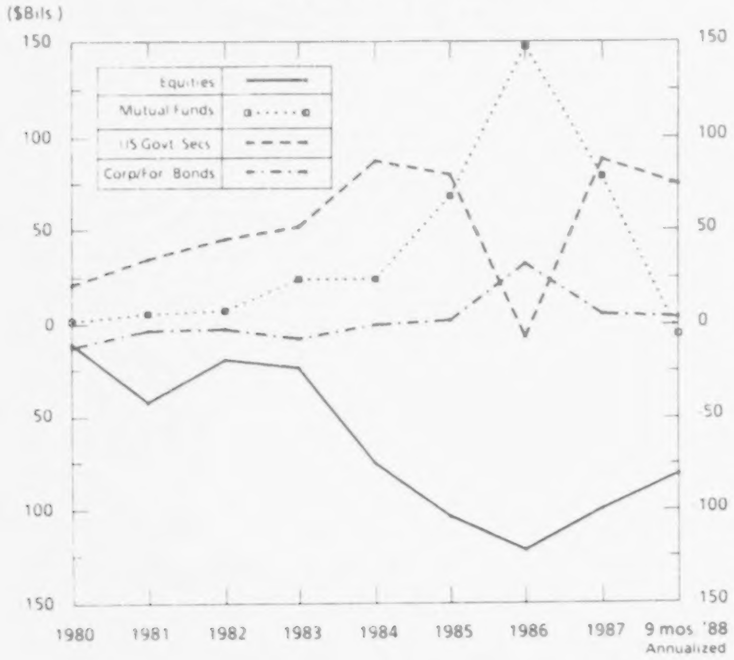
Since the crash, private foreign investors have shown renewed interest in governments, with net acquisitions of $18.5 billion through 3Q88. On the other hand, interest in corporate bonds which averaged over $6 billion quarterly for the first three quarters in 1987, dipped to $1.4 billion in the 4Q87, before recovering to $7.0 billion in the 3Q88.

Households

Much can be said about the household sector in the Flow of Funds analysis. This group includes individuals as well as trusts and non-profit organizations. But, because the household sector is a residual category, the numbers are suspect. Nevertheless, there are certain clear trends even if one doubts the accuracy of the specific data.

Individuals were sellers of direct stock in the 1980s, while increasingly being attracted to mutual fund equity shares, particularly during 1985-1987. Money market mutual funds waned in popularity as time deposits became increasingly attractive, notably after 1982 with the deregulation of interest rates. Overall, households' acquisition of financial assets tailed off after 1986. In 1988, these investors continued to sell equities, including mutual funds. Meanwhile, government and municipal securities appeared to receive funds shifted away from corporate bonds.

NET ACQUISITIONS BY HOUSEHOLDS



Of all the investor sectors, this category has shown the greatest penchant to follow the "flight to quality" theme, showing the most concern about risk. This preference is consistent with their surge in holdings of time deposits and large acquisitions of government and municipal securities in lieu of equities and corporate bonds. Indeed, except for some "suspicious" figures for 1985 and 1986, these investors consistently sold corporate securities while financial assets were being accumulated.

There is some tendency for the household sector to decline in relative importance compared to the institutional sector, insofar as the acquisition of financial assets is concerned. In 1980, the household sector acquired 64% of the total financial assets acquired by both these sectors that year. This percentage peaked at 68% in 1984, declined in 1985, and bottomed out at 51% in 1986. Surprisingly, the household sector's percentage of total financial assets acquired rebounded in 1987 to 56% and increased to 60% through the first nine months of 1988.

While the household sector's acquisition of financial assets slowed in 1986, the institutional sector's acquisitions increased through 1986. Since then, both sectors have acquired financial assets at a reduced pace. The household sector's acquisition rate of financial assets has dropped to below 1984 levels and the institutional sector's rate, below 1985 levels. These aggregate patterns of financial asset accumulations investment are consistent with the plunge in the economy's savings rate after 1984 and the continued low rate of recent years.

CONCLUSION

A host of factors were at work in the 1980s to bring our capital markets to their current state. While October 1987 will serve as the focal point for many reviews of the decade, there were changes underway long before the crash in both the supply of securities coming into the marketplace and the demand for these securities.

The supply of and demand for securities by investor sector during the 1980's sheds some light on price trends during this decade. Despite the shrinkage in the supply of equities since 1984, the demand for these securities remained strong and even strengthened for several investor sectors during the 1980's at least up until the crash. However, attractive real interest rates moderated the demand for equities while spurring the demand for fixed income instruments by different investor sectors.

Given the greater risk perceived by investors for equity since October, 1987, attractive real interest rates have kept fixed income instruments in a very favorable light. Indeed, the data indicate that traditional buyers of equities have avoided these investments or have suffered from decreased inflows. Unless certain investor sectors see equities in a different light or interest rates decline significantly, the price of equities will not reflect the improved profit picture except for those companies that are considered prime takeover candidates.

Jeffrey M. Schaefer Senior Vice President & Director of Research	Carolyn Hildebrandt Assistant Vice President & Director of Macroeconomic Studies	Grace Toto Research Assistant

VOLUME

	NOV 1988	YTD 1988	NOV 1987	YTD 1987	% CHAN YTD 1988-1987
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	134.4	163.9	179.5	189.6	-13.6%
AMEX (MILS.)*	8.5	9.9	11.3	13.9	-29.0%
NASDAQ (MILS.)*	108.9	123.1	126.0	150.9	-18.4%
REGIONAL EXCHANGE (MILS.)*	21.8	23.3	23.4	27.6	-15.6%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$96,467	$1,264,849	$113,300	$1,759,784	-28.1%
AMEX (MILS.)	1,772	29,466	2,517	48,352	-39.1%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	6,803	79,029	9,025	124,091	-36.3%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	15,975	165,397	11,829	191,627	-13.7%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	49.6%	52.8%	51.1%	51.4%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	11,292	103,479	7,276	173,116	-40.2%
AMEX OPTIONS	2,879	34,841	2,652	49,855	-30.1%
COMMODITY	22,768	227,391	16,871	212,139	7.2%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

PRICES
(END OF MONTH)

	DEC 1988	DEC 1987	% CHAN NOV 1988-1987
DOW JONES INDUSTRIALS	2168.57	1938.83	11.85%
STANDARD & POOR'S 500	277.72	247.08	12.40%
NYSE COMPOSITE	156.26	138.23	13.04%
AMEX MARKET VALUE INDEX	306.01	260.35	17.54%
VALUE LINE COMPOSITE	232.68	201.62	15.41%
NASDAQ COMPOSITE	381.38	330.47	15.41%

YIELDS

(MONTHLY AVERAGES)

	SEPT 1988	SEPT 1987	BASIS POINT CHG 1988-1987
BOND BUYER INDEX (20 BOND)	7.66%	8.26%	(60)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	9.82	10.18	(36)
Baa CORPORATE	10.90	11.31	(41)
RATIO Aaa CORPS. TO Baa CORPS.	0.90	0.90	0

UNDERWRITING

	1988	1987	% Change 1988-1987
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$273,370.0	$272,381.3	0.4%
Common Stock	$29,600.1	$41,673.5	-29.0%
# of Common Stock Issues	419	856	-51.1%
Preferred Stock	$7,309.8	$10,620.2	31.2%
# of Preferred Stock Issues	123	151	-18.5%
Corporate Debt	$236,460.1	$220,087.9	7.4%
# of Corporate Debt Issues	3,075	2,383	29.0%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$85,310.8	$77,010.7	10.8%
# of Issues	3,641	3,508	3.8%
Competitive	$26,686.5	$23,934.1	11.5%
# of Issues	3,526	3,497	0.8%

Source: IDD Information Services

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
"The 1988 Financing Rankings"	League tables for 1988 underwritings. Rankings cover domestic corporate underwritings of convertible debt, straight debt, preferred and common stock, IPOs, asset-backed and mortgage-backed bonds, rankings by industry sector and largest deals of 1988; international underwritings cover Eurobonds, worldwide offerings, international equities, and foreign bonds; municipal underwritings cover negotiated and competitive issues, general obligation and revenue bonds, public purpose, variable rate and refunding issues.	Investment Dealers' Digest 1/9/89
"Money Management Forum"	Special edition of "Institutional Investor" magazine covering over two dozen articles on money management topics ranging from portfolio insurance, LBOs, investment strategies, etc., to high yield bonds, international investing, tactical asset allocation, etc. Also includes sections on money management prepared by nine money management sponsors including Merrill Lynch, Chase Manhattan Bank and Nomura Investment Management Co.	Institutional Investor Volume Two December 1988
"Rookies of the Year"	This special issue of "Registered Representative" magazine profiles eight new brokers, their backgrounds and prospecting strategies. Light, but fun, reading, the rookies profiled range from a woman in her mid-20s, a former resident of Taiwan and Chinese language student, who now is a broker in Bethesda, Maryland, and utilizes finance student interns from Washington, D.C. area universities, to a Florida broker who joined the business two years ago after 25 years of running his own business of importing garments from Brazil.	Registered Representative January 1989

Item	Description	Source
"Deals of the Year"	This seven-page article highlights several deals which point up trends in international corporate finance which will stand out in 1989. These deals show financing techniques used in both short-term and long-term debt financing, hedging, international equity and mergers and acquisitions.	Corporate Finance "Euromoney" December 1988
"Tax Options for 1989: Revising Capital Gains Rates"	Author reviews political sentiment and options for a lower captial gains tax in 1989 and concludes the only chance for a cut may be to combine it with other tax changes that have a broad political appeal. Among the options discuss: a sliding scale for capital gains to discourage LBO-related activity; a reduction in the capital gains rate with a broad exemption on home sales; tax only the inflation component of asset sales; and raise tax rates on ordinary income for wealthy taxpayers while lowering the rate on capital gains. Article also briefly summarizes the history of capital gains taxation and the debate over the revenue effect of lower capital gains rates.	Congressional Quarterly 12/10/88
"Japanese Finance Survey"	In-depth, 32-page survey of the changing Japanese financial system. Following the removal of foreign-exchange controls in 1980, deregulation gained momentum, with the main impetus being the loss of banks' profitability. The banks new aggressiveness set off a chain reaction and all financial institutions started pressing for access to new business. The result has been a blurring of the distinction between different sorts of financial bussinesses that has yet to be arbitrated and settled. Article also reviews cultural and economic components of the evolution of the financial system.	The Economist 12/10/88

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SIA
SECURITIES INDUSTRY ASSOCIATION

TRENDS

An Analysis of Emerging Trends in the Securities Industry

Produced by the SIA Research Department

VOL. XV, NO. II

March 16, 1989

Back To The Future:
An Update on SIA's
Investor Activity Report

In the July 31, 1985 issue of Securities Industry Trends, the author posed the following question: "To what extent does the public participate in the stock market?" That issue of Trends introduced a new SIA publication, Investor Activity Report (IAR), which went a long way toward answering this question, indicating that the level of retail activity was substantially understated due to the past use of proxies.

Now, three and a half years later, new stock trading techniques and strategies have altered the accuracy, and therefore the conclusions, of the data reported in SIA's IAR data. However, the question over the size of public participation in the market is still an often asked one, particularly in light of the October 19, 1987 crash which seemed to dissuade this sector from participating in the equity markets as they had in earlier periods.

Therefore, this issue of Trends will serve three purposes. First, to review the past methodology and results. And second, to discuss, what we believe to be, inaccuracies in the data and to refine the numbers utilizing data available from the New York Stock Exchange. Finally, to note some implications of the declining role of the individual investor.

Past Attempts at Determining Retail Participation

In the past, two completely different methodologies have been used to determine retail participation in the U.S. equity markets (for a lengthier discussion see the 7/31/85 issue of Trends; this will only be a brief summary). Approximations for the institutional/retail mix has come from periodic statistical samplings of trades at NYSE member organizations, or by using data on reported trades by order size as rough proxies.

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The New York Stock Exchange employed statistical sampling to provide estimates through its Public Transaction Study (PTS). All NYSE member firms doing a public business participated, and firm data were collected for from one to five trading days before being expanded to represent aggregate share volume for the fourth quarter of 1980 for the entire NYSE member firm community. Share volume included all agency trades executed by NYSE member organizations on U.S. stock exchanges and the OTC before being expanded to represent aggregate share volume for the fourth quarter of 1980 for the entire NYSE member firm community. Share volume included all agency trades executed by NYSE member organizations on U.S. stock exchanges and the OTC market. It is likely that accounts which could not be clearly identified by member firms as retail became tabulated as institutional for PTS purposes. For this and other reasons, the sampling technique used probably underreported retail participation.

The results of the last PTS covering the fourth quarter of 1980 and prior periods were:

Table 1

	Proportion of NYSE *Publicly* Traded Share Volume		Proportion of *Total* Share Volume		
	Institution	*Retail*	*Institution*	*Retail*	*Member Trading*
4Q 1980	64.9%	35.1%	47.4%	25.7%	26.9%
1Q 1976	57.3	42.7	44.5	33.2	22.3
1Q 1974	58.9	41.1	44.6	31.1	24.3
1H 1971	59.7	40.3	45.7	30.8	23.5
FY 1969	55.9	44.1	42.4	33.4	24.2

Source: NYSE, Public Transaction Study, Fourth Quarter 1980, pp. 5 and 11.

It is clear from the Public Transaction Studies that there was an increase in the institutionalization of the marketplace from 1969-1980. Excluding member firm trading, institutions increased their share of public volume from 56% in 1969 to almost two-thirds by the fourth quarter of 1980. Correspondingly, individual participation plunged from 44% in 1969 to 35% 11 years later.

Including member firm trading, which has gradually risen in relative importance over time, the increase in the relative importance of institutions is considerably less dramatic, growing from 42% in 1969 to 47% by 1980. Meanwhile, individual participation on the NYSE shrunk from one-third of total volume in 1969 to slightly more than one-fourth of the total shares traded during the fourth quarter of 1980.

Since the fourth quarter of 1980, there have been no formal or comprehensive industry studies estimating the institutional and retail proportion of publicly traded share volume or total share volume (public trading plus member firm principal activities). So, those interested in determining retail share, have to a large extent relied on estimates based on reported trade size. For example, one proxy used as an indicator of retail participation is volume in transactions of 900 shares or less.1/

1/ The NYSE has recently increased the maximum size of orders classified as small from 900 to 1000 shares.

Table 2

Orders of 100-900 Shares as a
% of Total NYSE Trading Volume

1988*	12.6%
1987*	13.6
1986	10.8
1985	10.6
1984	11.3
1983	14.6
1982	16.2
1981	21.1
1980	24.7
1979	27.5
1978	30.2

*Orders of 100-1000 shares.

Source: NYSE

As seen in Table 2, small orders have fallen sharply in relative importance. Whereas they accounted for 30% of NYSE share volume in 1978, this percentage dropped to 12.6% by 1988. With the average trade size more than tripling from 559 shares in 1976 to 2,112 shares in 1988, the drop in importance of small orders is hardly surprising.

The wisdom of using orders of 900 shares or less as estimates of retail participation is questionable for several reasons. For one thing, individual transactions often occur in trades exceeding 900 shares. Indeed, data collected in the fourth-quarter 1980 PTS showed that only 49% of individual volume on the NYSE was included in trades of 900 shares or less while 51% was in trades exceeding 900 shares. Furthermore, nearly 11% of institutional volume was in trades of 900 shares or less. Consequently, estimates of NYSE retail share volume based solely on trades of 900 shares or less are inappropriate and sharply understate retail share volume. As average share order size increases by all customers, transactions in 900 shares on less become a poorer and poorer indicator of retail activity.

Table 3

Blocks of 10,000 shares and Over
as a % of NYSE Volume

1988	54.5%
1987	51.2
1986	49.9
1985	51.7
1984	49.8
1983	45.6
1982	41.0
1981	31.8
1980	29.2
1979	26.5
1978	22.9

Source: NYSE

One of the major indicators of trading volume cited frequently to emphasize the increased institutionalization of the marketplace is blocks of 10,000 shares and over. As shown in Table 3, such blocks have increased dramatically in relative importance.

More recently, such trades accounted for over 50% of the volume on the NYSE. Blocks of 10,000 shares and over have been steadily growing in relative importance on the Exchange. However, there is a great deal of confusion over what this percentage includes. For example, such blocks include member firms trading for their own account. Consequently, blocks of 10,000 shares and over cannot be interpreted as reflecting purely increased institutionalization of the marketplace since a large share of member firm trading is included in such blocks. Indeed, some observers have estimated that member firms trading principal positions are responsible for 30%-40% of trading in blocks of 10,000 shares and over on the NYSE. Finally, there are instances where individual investors and small businesses account for blocks of 10,000 shares and over.

Genesis of SIA's Investor Activity Report

Several years ago, SIA's Firm and Industry Analysis Committee (FIAC) initiated a project to obtain accurate and comprehensive institutional and retail share volume data by marketplace. SIA funded this project because of its importance and interest to the industry and to observers of the securities markets.

The FIAC initiated project included by year-end 1984 a comprehensive universe of reporting broker-dealers and participating institutions. The data are processed and aggregated by the Depository Trust Company with the cooperation of other depositories for SIA's use. The Association's Research Department has been compiling and analyzing the data in reports to describe trends in trading activity starting in May, 1985.

This new database, has produced the following results:

	Proportion of NYSE *Publicly* Traded Share Volume		Proportion of *Total* Share Volume		
	Professional Institution	*Retail*	*Professional Institution*	*Retail*	*Member Trading*
1988	50.2%	49.8%	38.8%	38.5%	22.7%
1987	55.9	44.1	41.1	32.5	26.5
1986	58.6	41.4	42.3	29.9	27.8
May-Dec 1985	61.1	38.9	45.3	28.9	25.8

Results of the data in the first two years showed the retail sector's proportion of NYSE share volume to be significantly higher than estimates based on proxies, such as trades of 900 shares or less. This conclusion should come as no surprise since both fourth quarter 1980 PTS data and current individual firm data reveal that a large proportion of retail share volume occurs in trades exceeding 900 shares.

However, increases in retail volume in 1987 and 1988 began to make the data look suspicious. That individuals should account for nearly 40% of total NYSE share volume in 1988, while an RRs dream, was clearly not in conformity with any "real world" analysis.

Food For Thought

Before focusing on what we believe to be the problem with the data, we will review the methodology by which we derive the data used in the IAR.

As noted previously, the institutional data are processed and aggregated by the Depository Trust Company through the Institutional Delivery System (ID). Institutional share volume is reported for all deliver-versus-payment and receive-versus-payment transactions, which includes almost all institutional volume. Despite NYSE Rule 387, which requires institutional trading to go through the ID system, we estimate that, perhaps, 3% of institutional transactions are not processed through the ID system.

Member principal trading information is filed weekly with the NYSE on Form 121, which requires that any round-lot purchase or sale of stock effected on the floor of the NYSE for members, allied members, or member organizations be reported regardless of where the order originated or by whom it was executed. The AMEX has an identical reporting requirement.

The retail trading figures are estimated after institutional activity and member firm trading are subtracted from the aggregate trading figures; in effect, the retail category is a residual. To the extent that institutional transactions are not captured in the Institutional Delivery System, it will be classified as retail/residual using our methodology, and therefore lead to an overstatement of the retail figure and a corresponding understatement in institutional activity.

The results which this methodology produced for 1987 were suspicious; retail activity trended upward throughout 1987 and then accelerated following the October 19, 1987 crash. In light of the increasing role of program trading, dividend capture plays, and corporate buy-back strategies in 1987, and an even greater role in 1988, SIA examined how transactions for these trading techniques and strategies were captured in the current reporting mechanism. Upon inspection, it was determined that in many cases, whether done for an institution or member firm, that most of this data was not reported through the ID system or on Form 121. Therefore, such data was captured in the retail/residual activity and overstated the activity of these investors.

For example, dividend capture plays grew from 3.3% of NYSE daily volume in 1987 to 10.1%, on average, in 1988. In addition, we assume that program trading averaged 10.6% of NYSE volume in 1987 and 1988, based on public NYSE program trading data for July-December 1988. We believe that all dividend capture activity and three-fourths of program trading activity falls in the retail (residual) category due to reporting drawbacks, and in good part accounts for the increased percentages being reflected by this category.

Methodology For Determining Adjusted Numbers

To get a more refined estimate of participation of retail investors, we eliminated certain factors from the residual category which are far removed from retail activity. With the exception of corporate buybacks, these components were distributed between the institutional and member firm categories according to our best estimates. Based on our adjustments, retail activity dropped to 18.2% of total NYSE volume in 1988 from 19.7% in 1987.

All dividend capture activity and a portion of program trading, amounting to about 4.5% of average daily NYSE volume, were shifted to the institutional category. In addition, about 3% of institutional activity which does not go through DTC's ID system was reallocated from the residual category to the institutional category. These adjustments put institutional activity at 54.6% of the total in 1988, compared with 50.1% in 1987. The remainder of program trading, 3.5% of daily volume, was shifted to the member trading category. Adjusted figures show member trading at 26.2% of volume in 1988 and 30.0% of volume in 1987. Corporate buybacks, 800,000 shares daily in 1987 and 3.5 million shares daily in 1988, were eliminated from our residual and not distributed to any of the three sectors discussed in our paper.

Average Daily Adjusted Activity
(Millions of Shares)

	1987	1988
Total	378.4	323.9
Retail & Other Activity	122.8	124.7
-Dividend Capture	12.6	32.8
-Program Trading	30.1	25.7
-Small Inst. Trades[1]	4.7	3.8
-Corporate Buyback[2]	0.8	3.5
Adjusted Retail Activity	74.6	58.9
% of Total	**19.7%**	**18.2%**
Institutional Activity	155.4	125.6
+ Dividend Capture	12.6	32.8
+ Program Trading	16.9	14.5
+ Small Inst. Trades	4.7	3.8
Adjusted Institutional Activity	189.6	176.7
% of Total	**50.1%**	**54.6%**
Member Trading	100.2	73.6
+ Program Trading	13.2	11.2
Adjusted Member Trading	113.4	84.8
% of Total	**30.0%**	**26.2%**

---

[1] Small institutional trades not clearing through DTC's ID system (an estimated 3% of institutional activity).

[2] Estimates based on Salomon Brothers' data.

Results of our adjusted figures follow, with the corresponding unadjusted numbers in parenthesis:

Proportion of NYSE *Publicly* Traded Share Volume

	Professional Institution	*Retail*
1988	73.9% (50.2%)	24.6% (49.8%)
1987	71.5 (55.9)	28.2 (44.1)

Proportion of *Total* Share Volume

	Professional Institution	*Retail*	*Member Trading*
1988	54.6% (38.8%)	18.2% (38.5%)	26.2% (22.7%)
1987	50.1 (41.1)	19.7 (32.5)	30.0 (26.5)

On an intuitive basis, these figures seem to reflect a more accurate indication of retail activity.

Stock Market Participation: American As Apple Pie?

Many market observers, professional and non-professional, continue to use NYSE reported share volume as a benchmark indicator of securities industry (and even economic) health. While this may once have been a key indicator, we submit that continued reliance on volume, without looking at the make-up of such volume, leads one to faulty conclusions. Indeed, when one examines reported volume carefully, trading strategies dependent on arbitrage opportunities, often executed by the larger firms, have over time become an increasingly large part of volume. In addition, dividend programs and corporate buybacks have also led to increases in reported volume. Not only are these strategies limited to professionals, but they generate relatively little income for securities firms. On the other hand, trading on fundamental stock analysis must seem nostalgic to some brokers.[2]

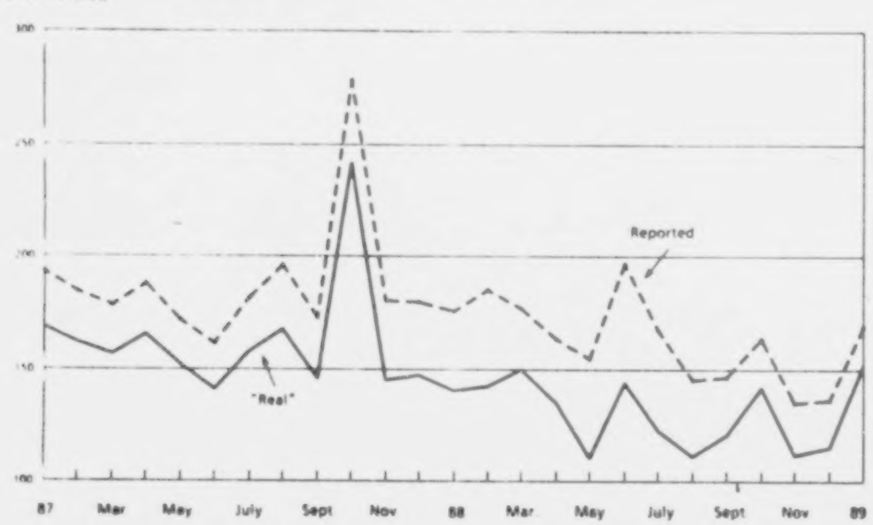
So, traditional methods of correlating increasing turnover rate with stock market profitability is no longer a sure bet. That is, one must not assume an increase in volume is due to an increase in public participation.

---

[2] We are not questioning the value of trading strategies, just their impact on analyzing NYSE volume.

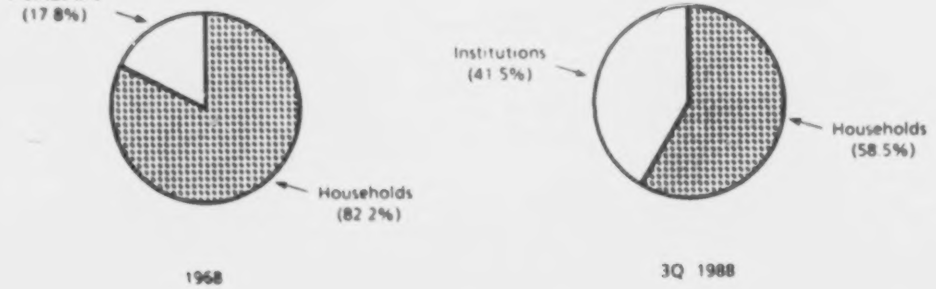
For instance, during 1987 and 1988 reported volume in the securities industry greatly exceed "real volume"; that is, volume which excludes trading strategies. As the graph below indicates, the disparity between reported and "real volume" is fairly significant. More to the point, "real volume" is well below post-crash levels, while reported volume continued strong, even exceeding post-crash levels, for half of 1988. Disturbingly, the retail investor's confidence in the equity market has yet to recover from the crash.

Comparison of Reported vs. "Real" NYSE Average Daily Share Volume



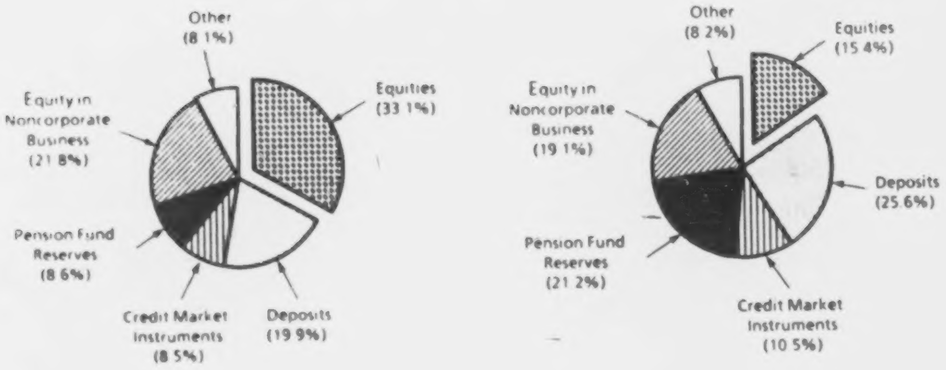
The shock suffered by many investors merely reinforced a trend which has developed over the past twenty years: there has been a sea change in the individuals' appetite for equities. Higher real interest rates, more perceived risk and higher taxes have blunted incentives to purchase equities directly and made other financial assets relatively more attractive. From a 82.2% share in 1968, individuals held 58.5% of all outstanding equities as of September 30, 1988.

Holdings of U.S. Corporate Equities



Further, individuals have significantly increased their holdings of other financial assets. Alas, equities have shrunk from 33.1% to 15.4% of all financial assets held by individuals.

Distribution of Retail's Financial Assets



1968

3Q 1988

However, statistically reporting the demise of the retail investor should be more than an academic exercise. Certainly, the retail investor adds stability to the market by taking a longer term approach to investing than non-retail investors; and corporate management certainly appreciates this approach.

But, perhaps more importantly, the ownership of equity by the individual is a core ingredient of U.S. style democracy. The point being, the individual is willing to commit funds to equities, if he believes that he has a fair chance of realizing an adequate return. For the individual to own a piece of America is a statement, of not only his faith in the system, but that he believes in its preservation. The declining participation in the equity marketplace is something for all of us to be concerned about. Reversing this trend should be an important goal and merits deliberate, thoughtful policies (tax and otherwise) to achieve it.

Grace Toto
Research Associate

David G. Strongin
Director,
International Finance

UNDERWRITING

	JAN 1989	JAN 1988	% Change 1989-1988
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$19,470.8	$19,299.4	0.9%
Common Stock	$1,674.2	$979.9	70.9%
# of Common Stock Issues	17	17	0.0%
Preferred Stock	$325.0	$1,068.0	-69.6%
# of Preferred Stock Issues	6	17	-64.7%
Corporate Debt	$17,471.6	$17,251.5	1.3%
# of Corporate Debt Issues	206	251	-17.9%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$5,308.1	$4,991.4	6.3%
# of Issues	157	219	-28.3%
Competitive	$1,881.5	$1,893.7	-0.6%
# of Issues	263	274	-4.0%

Source: IDD Information Services

VOLUME

	DEC 1988	YTD 1988	DEC 1987	YTD 1987	% CHAN YTD 1988-1987
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	135.5	161.5	178.5	188.7	-14.4%
AMEX (MILS.)*	11.1	10.0	13.4	13.9	-28.0%
NASDAQ (MILS.)*	118.5	122.8	135.1	149.6	-18.0%
REGIONAL EXCHANGE (MILS.)*	N/A	N/A	30.9	27.9	N/A
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$91,202	$1,356,051	$114,214	$1,873,598	-27.6%
AMEX (MILS.)	1,382	30,848	2,784	51,137	-39.7%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	7,281	86,310	8,665	132,756	-35.0%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	16,497	181,894	17,155	208,782	-12.9%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	51.1%	52.7%	48.9%	51.2%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	8,305	111,784	8,998	182,114	-38.6%
AMEX OPTIONS	2,629	37,470	2,916	52,771	-29.0%
COMMODITY	18,494	245,885	16,656	228,795	7.5%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

YIELDS

(MONTHLY AVERAGES

	NOV 1988	NOV 1987	BASIS POINT CHG 1988-1987
BOND BUYER INDEX (20 BOND)	7.46%	7.95%	(49)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	9.45	10.01	(56)
Baa CORPORATE	10.48	11.23	(75)
RATIO Aaa CORPS. TO Baa CORPS.	0.90	0.89	1

PRICES

(END OF MONTH)

	JAN 1989	JAN 1988	% CHAN JAN 1989-1988
DOW JONES INDUSTRIALS	2342.32	1958.22	19.61%
STANDARD & POOR'S 500	297.47	257.07	15.72%
NYSE COMPOSITE	166.63	144.13	15.61%
AMEX MARKET VALUE INDEX	323.02	269.10	20.04%
VALUE LINE COMPOSITE	244.16	210.73	15.86%
NASDAQ COMPOSITE	401.30	344.66	16.43%

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SIA SECURITIES INDUSTRY ASSOCIATION

TRENDS

An Analysis of Emerging Trends in the Securities Industry
Produced by the SIA Research Department

Vol. XV, No. 3 April 14, 1989

OBSERVATIONS ON THE REGIONAL FIRM

The past 18 months have presented memorable challenges to the securities industry and particularly to regional and local firms, which focus so importantly on the retail business. This issue of Trends highlights key shifts in business and performance patterns for the securities industry and for regional firms.[1]

This overview of the past performance of regional firms and challenges for their future is approached in four parts:

- Performance of the securities industry
- Performance of regional firms
- Regionals' performance vs. national firms
- Key questions on the business approach of regional firms

---

[1] Based on a presentation by Edward I. O'Brien at SIA's April, 1989 Regional Conference in Chicago. SIA welcomes contributions to Trends from all sources, from member firms as well as others, relating to the securities industry and capital markets. Please send submissions to the attention of Jeff Schaefer or George Monahan, SIA Research Department.

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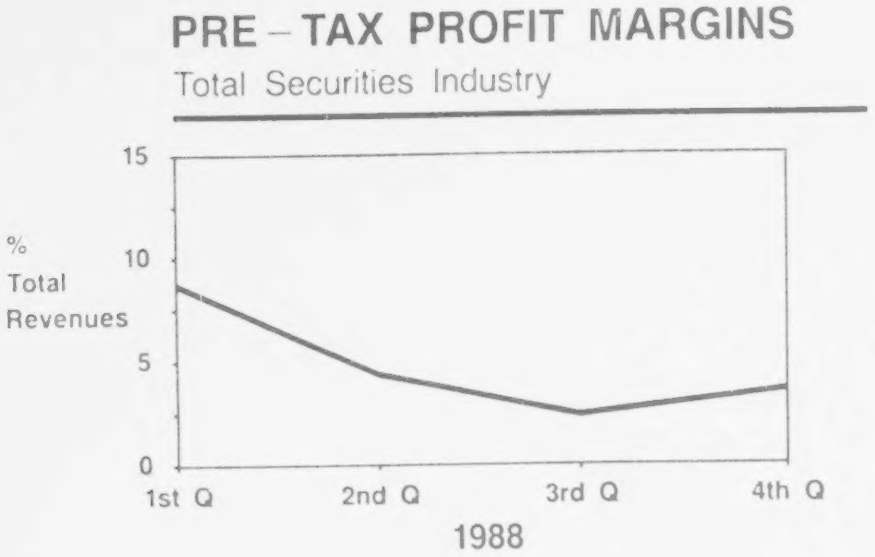
SECURITIES INDUSTRY PERFORMANCE

The past 18 months have presented memorable challenges to the securities industry and particularly to regional and local firms, which focus so importantly on the retail business. But the securities business is a cyclical business and so it will improve. In fact, preliminary indications show that the first quarter of this year produced somewhat improved results. Today, therefore, seems like a particularly good time to pause and reflect on where the securities industry stands today, upon the nature of securities and regional firms, the markets they serve and, most importantly, whether today's approaches are the best they can be in the competitive and changing environment the industry faces.

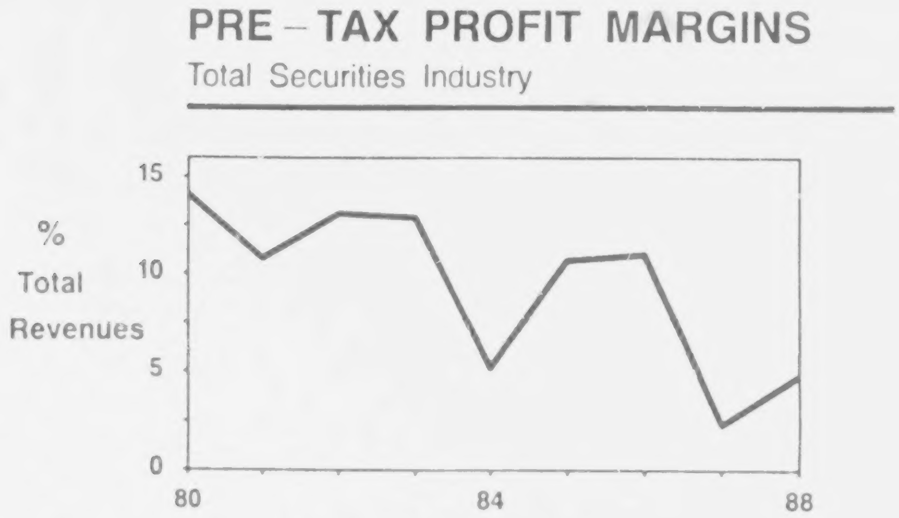
On the whole, retail profitability in regionals has not been satisfactory for at least the period since October, 1987. In fact, the profitability of the securities industry itself, both retail and institutional, large and small, has also been unsatisfactory. Fortunately, as **Exhibit 1** shows, the industry as a whole has finally had an up quarter, producing a 1988 fourth quarter pre-tax profit margin of 3.6%. These results are, of course, far below long-term or satisfactory levels.

EXHIBIT 1



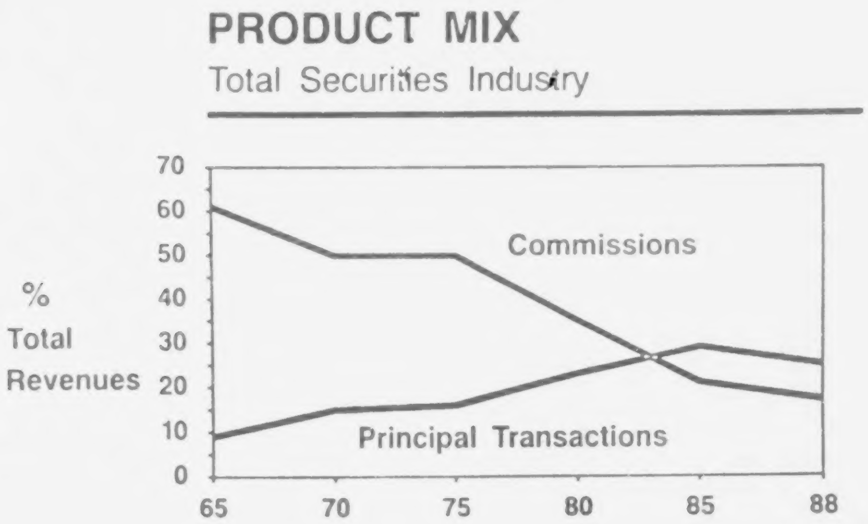
The nine-year snapshot of pre-tax profit margins for the securities industry in **Exhibit 2** shows the marked deterioration from the profitability levels early in this decade. As can be seen, we've come from 14.1% in 1980 to 4.8% for all of 1988. Nonetheless, perhaps the gloom is beginning to lift.

EXHIBIT 2



The long-term industry trend away from the commission business continues. **Exhibit 3** shows that industry commissions fell from 60% of industry revenues in 1965 to 17% last year. Conversely, principal transactions, defined as trading and investment gains, rose from less than 10% of revenues in 1965 to a peak of around 30% in 1985 and about 25% last year. If the investment banking-generated revenues, such as M & A, private placements and underwritings are added to principal transactions, it accounts for over 60% of industry revenue last year.

EXHIBIT 3



Looking at the quarterly performance of regional firms last year, **Exhibit 4**, shows that the first quarter 1988 pre-tax profit margin of 4.1% declined to 1.3% in the fourth quarter...not a pretty sight. As mentioned earlier, however, preliminary indications are for improved results among regionals in the first quarter of this year. Still, it is clear 1988 was a very tough year for regional firms.

EXHIBIT 4

PRE – TAX PROFIT MARGINS

Regional Firms

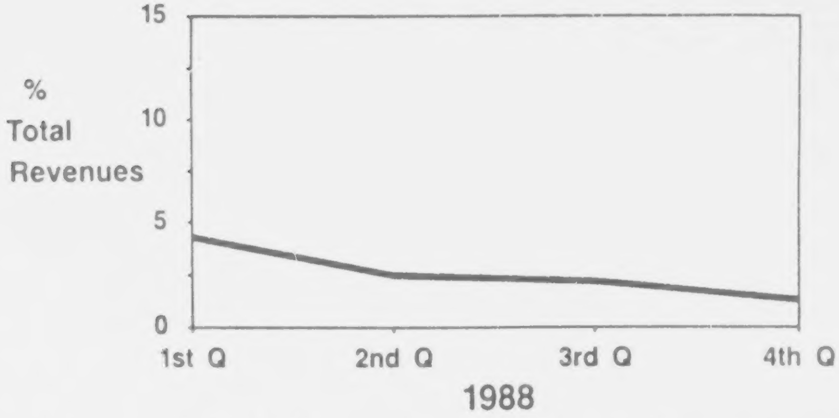
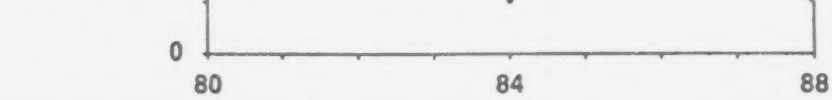


Exhibit 5 highlights the profit performance of regional firms over the 80s. In 1980, regional firms as a group had a pre-tax profit margin of 14.7%. For 1988, it was only 2.6%. The cyclicality that distinguishes the securities industry is clear and thus future results will undoubtedly get better. Nonetheless, the trend here is troublesome which raises a fundamental question: "Are there changes occurring in the markets that regional firms serve that call for new approaches?"

EXHIBIT 5

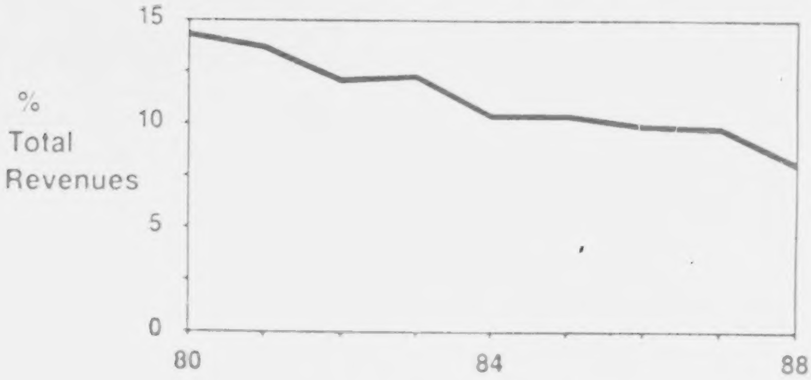
PRE – TAX PROFIT MARGINS

Regional Firms



The consolidation and concentration that has taken place in the securities industry is a familiar story to all. **Exhibit 6** graphicly depicts the decrease in total industry revenues attributed to regional firms during this decade.

EXHIBIT 6

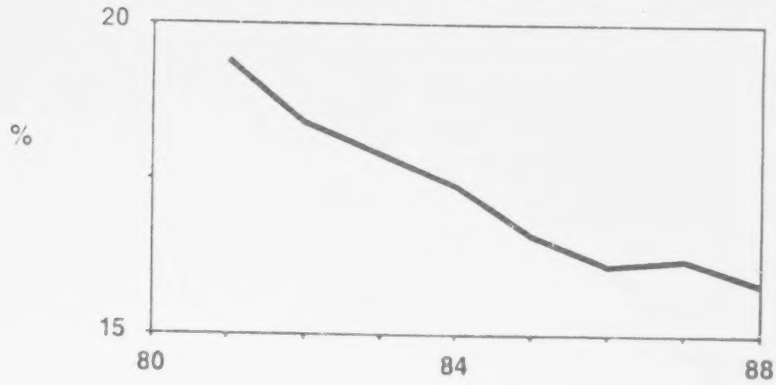


SHARE OF TOTAL INDUSTRY REVENUES

Regional Firms

Employee counts provide another measure of the same trend. Looking at regional firms' share of industry employees in **Exhibit 7** also emphasizes this consolidation.

EXHIBIT 7



SHARE OF TOTAL INDUSTRY EMPLOYEES

Regional Firms

Although regional firms' share of industry employment, revenues, etc., has fallen, this does not mean that regional firms themselves are smaller. For instance, based on SIA's membership as published in SIA's 1980 yearbook, out of the top 100 regional firms (defined in the yearbook as being headquartered outside New York City and not to be confused with the SIA/SEC/NYSE "regional" category used throughout the rest of this analysis), only two had capital above $45,000,000 -- in 1988, 31 did.

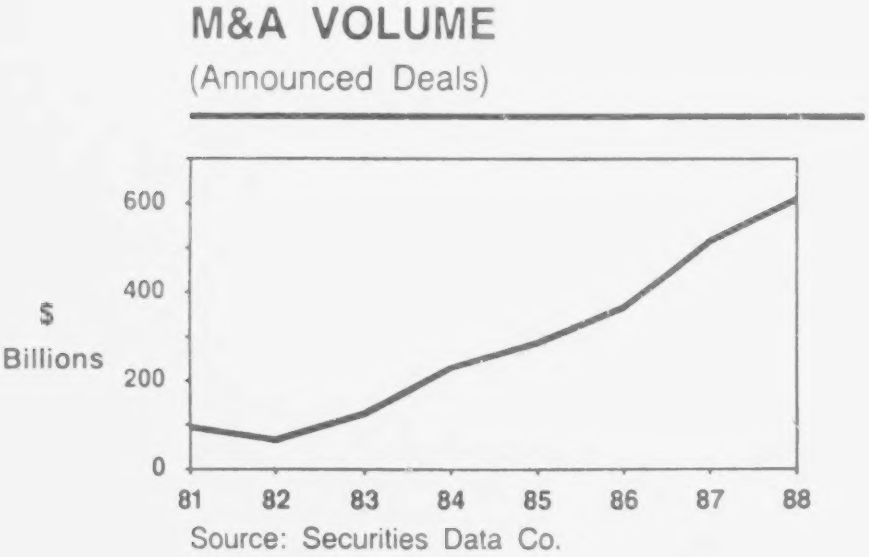
One more statistic from comparison of these two yearbooks which best sums up the intense competition in which regional firms engage: 40 of the top 100 regional firms in 1980 are gone from the current list!

The main point is though the regional segment of the industry is growing in absolute dollar terms, there has also been consolidation and regionals now make up a smaller portion of the total securities industry. This reflects two primary facts:

- Consolidation among regional firms;
- The retail business, which dominates the business of regional firms as a group, has grown more slowly than other lines of activity.

One example of the fantastic growth in a non-retail business line, one in which regional firms have not been important participants, is M&A activity. **Exhibit 8** shows announced M&A activity has increased more than six-fold in six years!

EXHIBIT 8



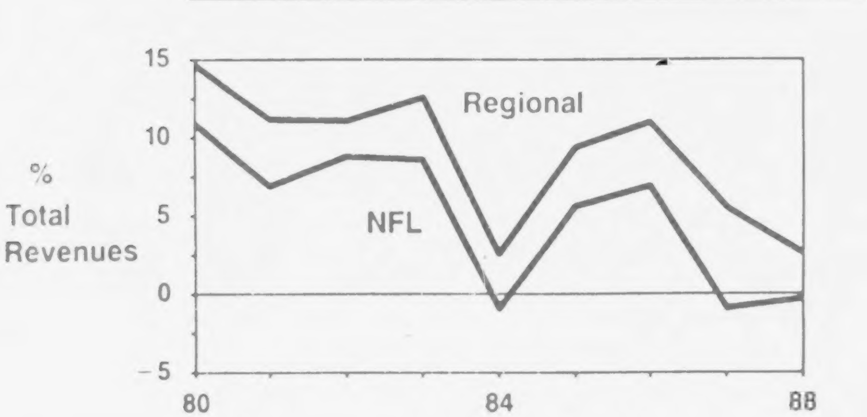
Source: Securities Data Co.

But lest one feels there is only bad news in regional firms' performance, let us look at how their performance stacks up against another segment of our industry, the national full line firms.

As **Exhibit 9** shows, regional firms have consistently outperformed the national full line firms, the very firms many regional firms consider their main competitors. So, with all the difficulties of regionals' main business, they still manage to outperform their primary competitors.

EXHIBIT 9

PRE-TAX PROFIT MARGINS



As an aside, some of the strong points of regional firms stems from their smaller size. A smaller size seems to permit closer personal relationships; there are fewer layers of management; people seem to know each other better, and they seem to take a longer term view of the business.

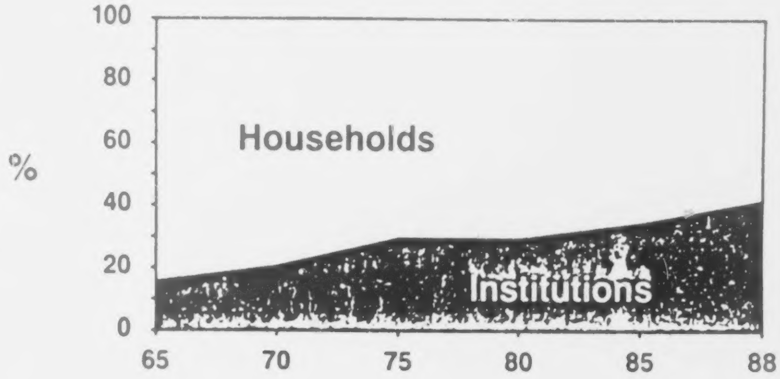
The theme of SIA's 1989 Regional Conference was "Retail Profitability: Opportunity or Oxymoron?" This title, itself, raises a critical question for regional firms. In a sense, most regional firms have really bet their business on the individual investor. This has long served them well. However, today's environment should raise a series of questions about firms' business strategy. Are the assumptions which have been made correct, or are things changing in a significant and different way?

Also, there seems to be a growing distinctiveness among the more successful regional firms. In the past, the label "regional firm" conjured up a very specific firm and way of doing business. Now it seems firms are formulating very different ways of addressing the retail market. In the course of this program, you'll be hearing from some good illustrations of this point. Edward D. Jones, Piper Jaffray, Alex. Brown, Legg Mason and Raymond James, to name a few, certainly are distinguishing themselves in quite different ways in the retail business. One major question each regional firm should ask itself is: "Is your retail strategy a winning one?"

The institutionalization of our markets has received much comment. Today, institutions own 40% of U.S. equities (Exhibit 10) and account for a much higher proportion of total trading activity of these shares. Although this obviously is not a proxy for the retail market as a whole, it still makes one want to understand more of exactly what is going on among current and potential individual customers, it argues for a fresh look at retail strategies, at diversification. Or, in other words, "Is retail enough for regional firms' success?"

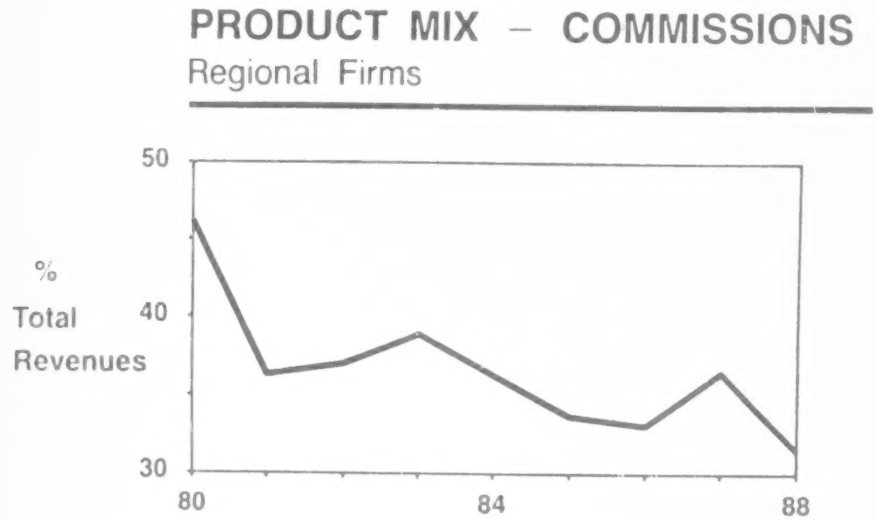
EXHIBIT 10

HOLDINGS OF U.S. EQUITIES



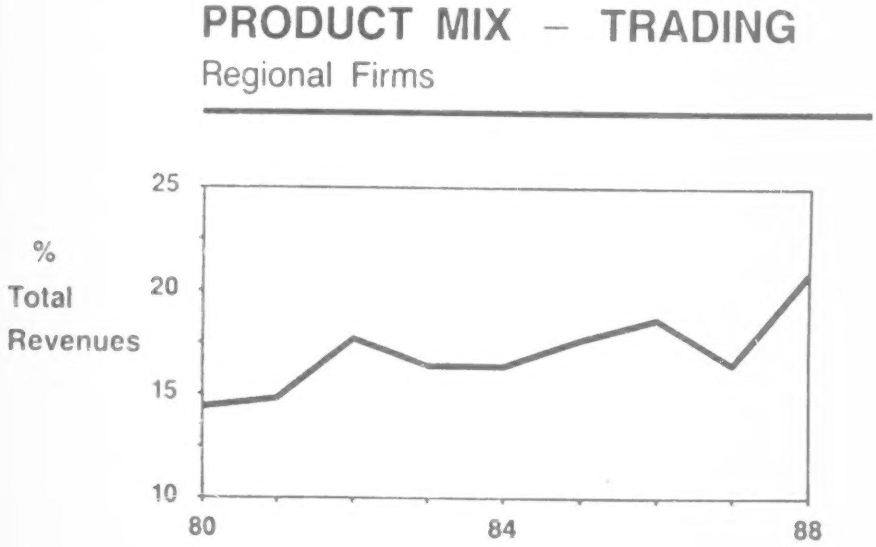
Let's now turn back to the regional firm business performance. While commission business at regional firms has declined along with industry trends, it still accounts for over 30% of regional firm revenues (**Exhibit 11**) and is still regional firms' #1 source of revenues; 31 1/2% for 1988. Another question: Has October 19 produced a temporary or a more durable drop here?

EXHIBIT 11



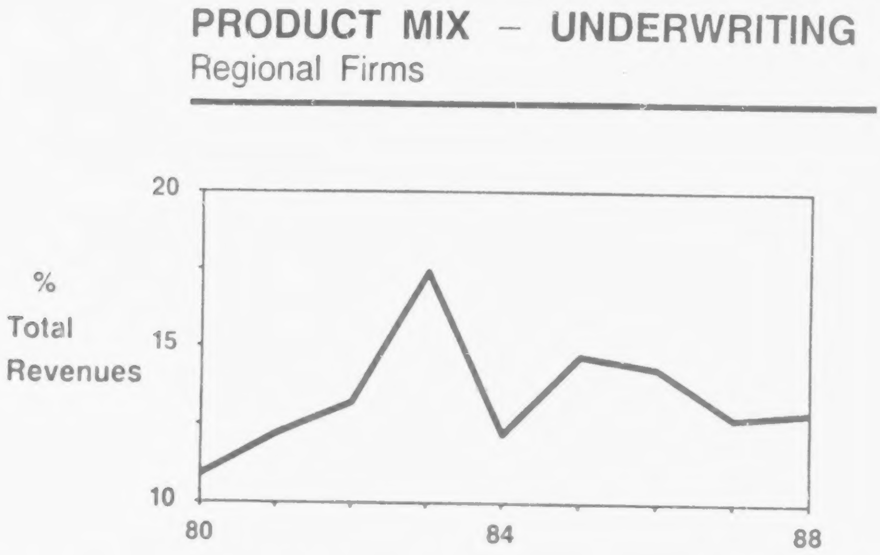
Regionals have participated in the trend toward principal business. The surge in 1988 (to 20.9% of total regional firm revenues, **Exhibit 12**) reflects the interest of customers in fixed income securities. Again, is this shift a temporary reaction or a new retail fact of life?

EXHIBIT 12



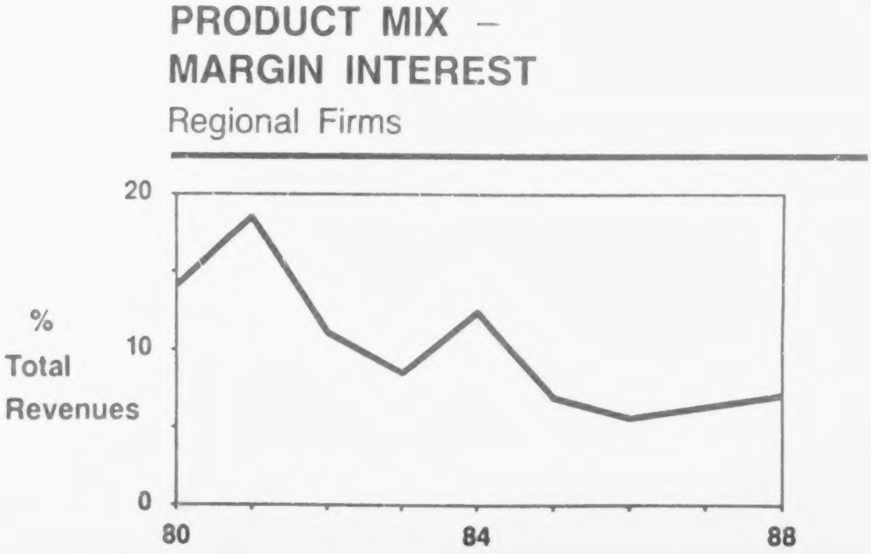
As is well know, underwriting has experienced radical changes during the 1980s. Rule 415 and legislative changes concerning municipal bonds are but two examples where important sources of business for regional firms have been adversely impacted. This has led to increased domination by the largest firms and growing challenges for regionals. Nonetheless, regional firms have been holding their own and generated 12.9% of your total 1988 revenues through underwriting (**Exhibit 13**).

EXHIBIT 13



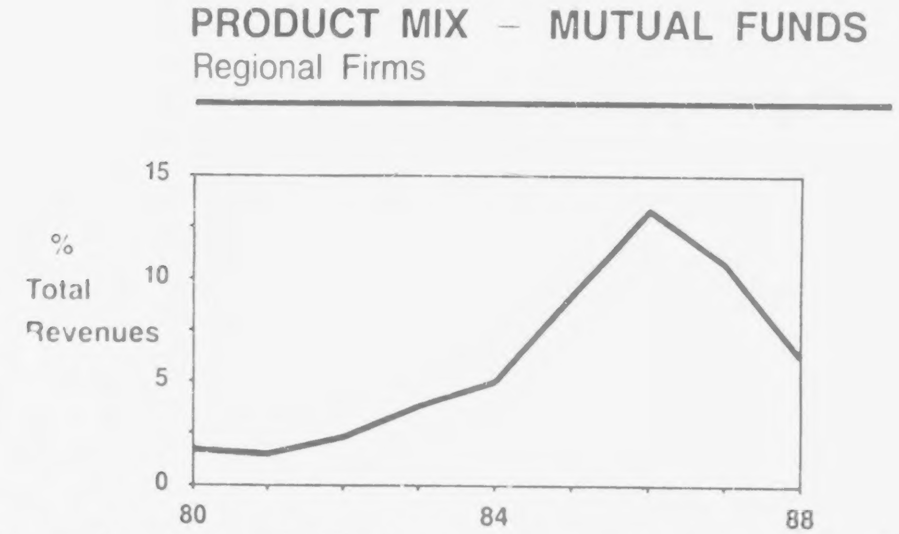
Not too many years ago, interest profits associated with free credit balances and margin loans provided a major source of profits from the retail business. Money market funds and sweep accounts have produced significant changes in the economics of the retail business. Nonetheless, interest profits are still an important factor to the retail business, albeit less than in the past. Although profit figures from this source are not tracked, revenues from margin interest are shown in **Exhibit 14**.

EXHIBIT 14



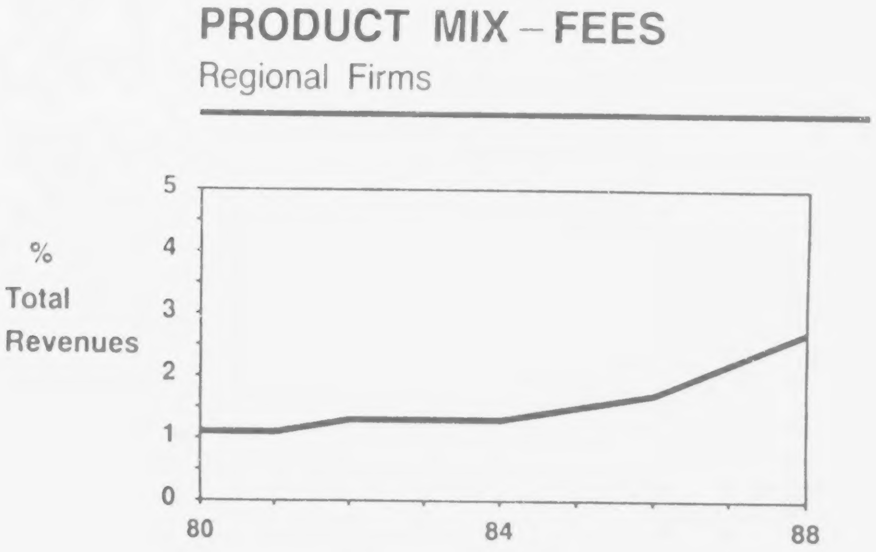
Mutual funds have been one of the big success stories for regional firms, climbing from 1.7% of their revenues in 1980 to a high of 13.3% in 1986; however, since then it has fallen back down to 6.2% last year (**Exhibit** 15). Again, the question of exactly what the long-term impact of October 19 will be needs to be examined. Chances are, due to their popular success, that mutual fund sales will come back strongly in the next up cycle.

EXHIBIT 15



Although still relatively small compared to other business lines, fees (from account supervision and management) represent an area of important progress for regional firms and, some argue, important potential. From 1.7% of regional firms' revenues in 1980, fees have grown gradually but steadily to 2.7% last year, and that's on a higher revenue base (**Exhibit** 16).

EXHIBIT 16



These have been some of the highlights of regional firms' revenue picture. In sum, regional firms have been primarily committed to the retail business, which has been in a slump for the past 18 months. More significantly, there appear to be various significant changes in the retail business that have made it more difficult to be profitable, including the loss of interest profit via free credit balances, legislative changes affecting the municipal business, and growing domination of underwriting by large firms. In short, the retail game is changing. But a main question remains: are regional firms also changing to meet these changes?

What about expenses? Well over half of the regional firms' expenses are people. The formulas utilized to compensate brokers proved very effective last year in quickly and dramatically producing cost reductions. Aggregate regional firm revenues dropped 15.3% last year from 1987. As shown in **Exhibit 17**, RR compensation dropped from 28.3% of regionals' revenues in 1987 to 25.2% in 1988. From a profitability standpoint, that was a stellar performance. Of course, this also means the firms' most important strength, its brokers, are hurting.

EXHIBIT 17

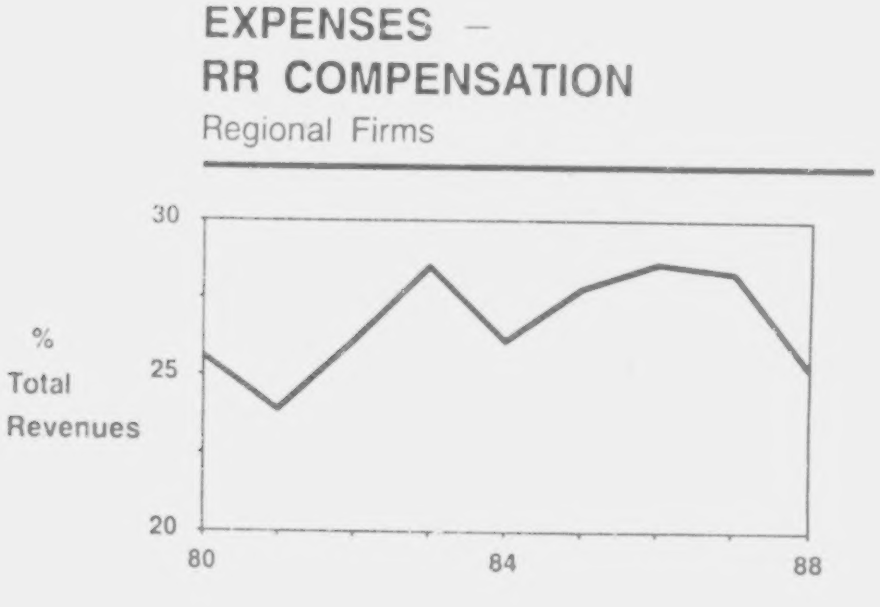


Exhibit 18 shows a disturbing trend in the so-called fixed portions of compensation, paid to clerical and administrative personnel; that is, all non-producing people. While the broker compensation formulas, once in place, automatically flex with revenues, this category of compensation is changed only through management intervention. Most importantly, of course, this involves controlling staff levels. In the past year, that has meant layoffs. Note that 1988 costs in this area, at 29 1/2% of total revenues, consumed a full 5 percentage points more of revenues then in 1980.

EXHIBIT 18

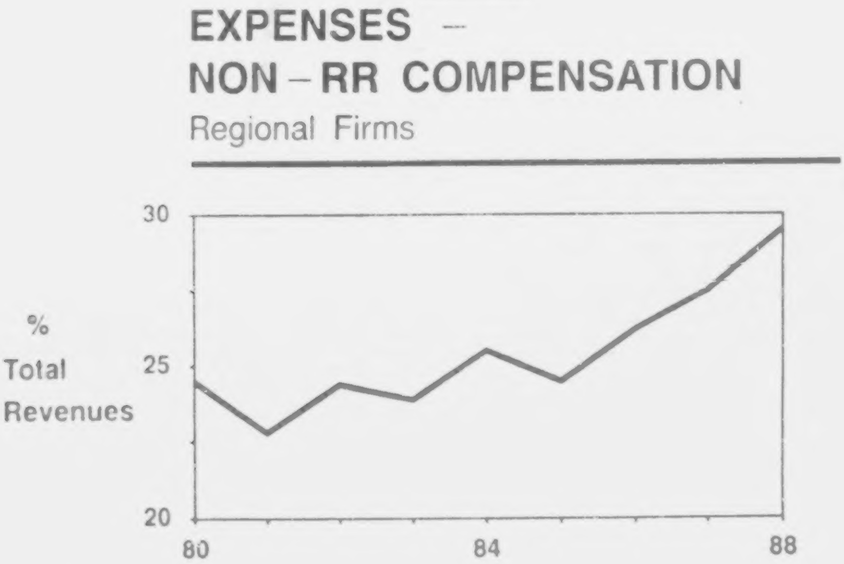
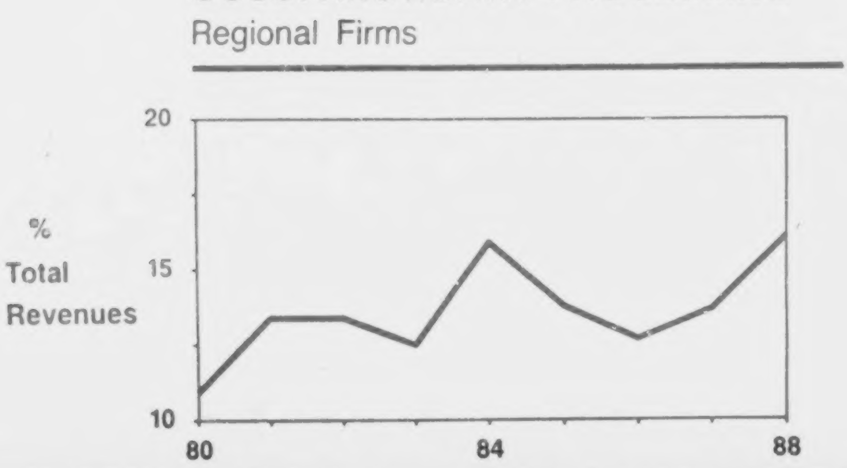


Exhibit 19 illustrates a problem which all securities firm management is very familiar with: coping with fixed costs in a cyclical business. Combining communications, occupancy and data processing costs,, the 1988 percentage of total regional revenues is 16.1%, which is more than 5 points above what it was in 1980. Many regional firms have leaned toward fixed costs via self-clearing, in-house data processing and so forth. Perhaps it's time, at least for some, to reexamine this whole area.

EXHIBIT 19



Productivity is a crucial issue for securities firms. **Exhibit 20** shows figures from SIAs annual surveys of RR production. As can be readily seen, there is evidence that regional firms are losing ground to the nationals in terms of the average gross production of their RRs. The classical scenario was that regional brokers produce less, but were paid at higher percentage rates, resulting in W-2 compensation that was roughly equivalent to that of their national competitors. Similarly, the regionals were said to spend more on direct compensation and less on sales support. Are these concepts still valid?

EXHIBIT 20

RETAIL RR PRODUCTIVITY

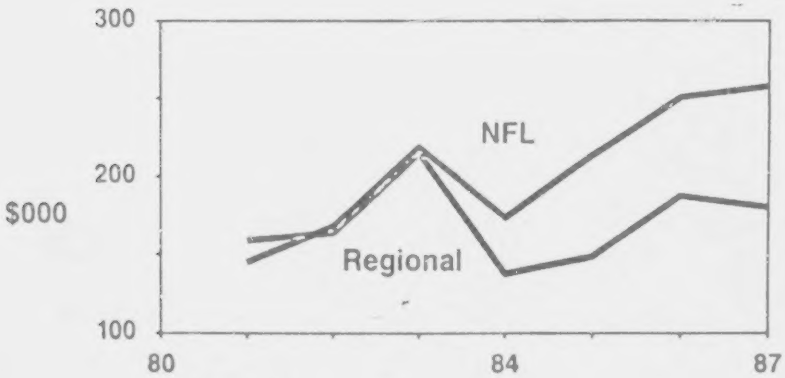
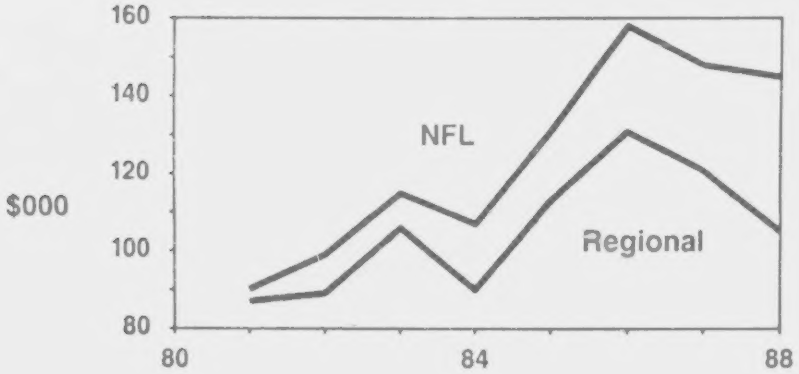


Exhibit 21 takes another look at a comparison of regional and national firm productivity, in this case using total revenues per employee. The concern it raises is the apparent widening of these measures.

EXHIBIT 21

REVENUES/EMPLOYEE



The purpose of these observations is to focus more on the questions than on answers. The answers will be different from firm to firm. It is also crucial to test long held assumptions. Over time, habits of doing things creep into our thinking. Those assumptions may no longer be valid. And if relied upon, they can lead to the wrong conclusions.

Mentioned earlier were five different firms with five different approaches to the retail market and to this industry. They were mentioned to make a point. And it is this:

Aside from all else, the key to success in this business is uniqueness. The ability, in fact the courage, to carve out your own way of looking at things and, based on your own culture, to be different. Two other questions suggest themselves:

- Is the securities industry in cyclical decline, entering a long-term down period?
- Are there any basic rules of the road which should be kept in mind?

As to the first question, the answer is, **No!** The securities industry is not entering a time of decline, despite the increased competitiveness and lower margins. Why? There are two reasons.

1. The American and the worldwide society have entered an era of "financial regeneration and awareness." People, governments, and the public perception is that financial management can contribute to a better life and play a part in alleviating the needs of people around the globe.

2. The securities industry has the experience and the means to play a central, in fact a critical, role in the advancement of the goals of this worldwide phenomenon.

So we have a demonstrated need and the means to advance that need.

As to the second question, there are three basic rules of the road, simple Yes! Somewhat pedestrian Yes! , But nevertheless, they have stood the test of time and travail:

1. The number #1 rule for any business is to have a vision or a goal for the firm. The five firms mentioned have it. They have decided what they want to be, where they want to go, and how to get there. As Alice in Wonderland said, if you don't know where you want to go, it doesn't really matter which road you take to get there. But we know that usually leads to catastrophe.

2. The second inviolate rule can be called many things, but let's call it "client" preoccupation. You need to know, really know, what the client wants or needs, and be preoccupied in doing just what he wants or needs. And this applies to any client of any size, no matter whether it's an individual, an entrepreneur, a government, a corporate client, or an institution.

3. The last rule revolves around the first two, and it is the profit rule. In business, you must understand fully, and have the entire organization understand it, that you expect to earn a respectable profit from your vision and from your service. That means cost consciousness across the board for all services, for clerical, sales, marketing and management. There is no substitute for it. And coupled with vision and service, it works!

Edward I. O'Brien
President
Securities Industry Association

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SIA
SECURITIES INDUSTRY ASSOCIATION

TRENDS

An Analysis of Emerging Trends in the Securities Industry

Produced by the SIA Research Department

Vol. XV, No. 4 May 30, 1989

INVESTMENT BANKING: THE ONLY GAME IN TOWN

SPECIAL EMPIRICAL REPORT: 1988 PERFORMANCE OF DOMESTIC BROKER-DEALERS

Highlights

1. The securities industry, measured only by domestic broker-dealer operations, posted $2.5 billion in pre-tax profits last year, double 1987's crash-impacted level but half 1986's profits. The 1988 gain was concentrated in investment banking firms while retail firms struggled to remain profitable.

2. The largest retail houses, the National Full Line firms, posted losses in their broker-dealer units for the second straight year. Their 1988 revenues were down 7%; revenues from commissions and mutual fund sales fell 33% and 31%, respectively.

3. Regionals' 1988 revenues shrank 15% and profits plummet 61% to their second lowest level of the Eighties. Commissions fell 27% while mutual fund revenues dropped 52%!

4. Discounters' 1988 profits fell 70% on 33% less commission revenue and 19% less overall revenue.

5. Large Investment Banks also had a 36% drop in commissions. However, the M&A and repo business boomed, increasing almost $3 billion in 1988. Thus, total revenues increased 15% and profits doubled.

6. New York City-based firms, despite the commission pinch, had a 1988 $1 billion M&A and repo-related revenue increase for a 24% gain in total revenues while profits quadrupled.

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OVERVIEW

The bears were still running on Wall Street's retail track! The financial performance of domestic broker-dealers in 1988, the first full year after the October 1987 crash, was critically dependent upon whether they were retail-oriented.

The largest retail firms, the National Full Line (NFL) firms, posted losses in their broker-dealer units for the second straight year as a group. Their 1988 revenues were down 7% and the retail bellwether business lines, commissions and revenues from mutual fund sales, fell 33% and 31%, respectively, from 1987's level.

Regional firms' broker-dealer units, predominantly retail-oriented, saw 1988 revenues shrink by 15% and profits plummet 61% to their second lowest level of the Eighties. Commissions fell 27% while mutual fund revenues dropped 52%!

Discounters also felt the pinch with the absence of the individual investor. Profits were slashed over 70% on 33% less commission revenues and 19% less overall revenues.

These same business areas were also off at the institutional, investment banking houses. The Large Investment Bank (LIB) broker-dealers had a 36% drop in commission revenues while mutual fund revenues were halved. However, their investment banking advisory and repo reverse repo businesses boomed with an increase of about $3 billion in 1988 revenues. These gains offset depressed business lines and yielded a 15% increase in total revenues and a doubling of profits from 1987's level.

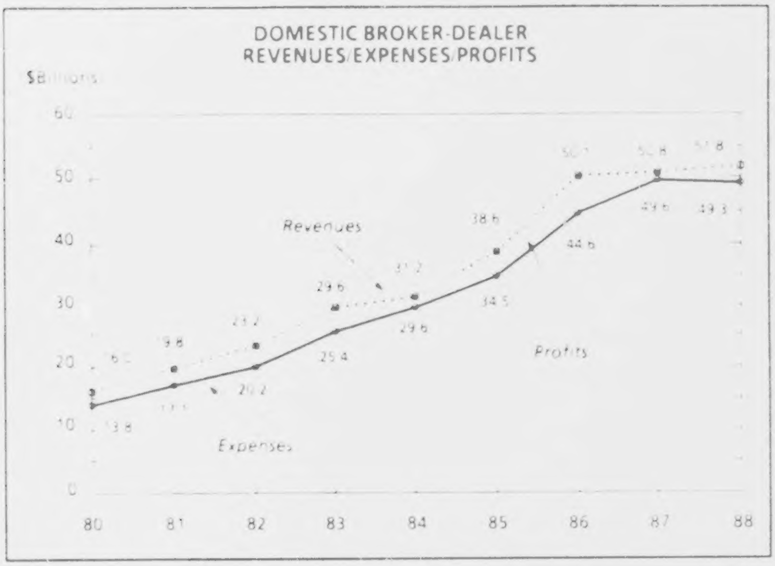
For the New York City-based "regionals" (NYCs), commissions also suffered cuts of 31% last year while mutual fund revenues fell 29%. But M&A and repo-related revenues increased $1 billion for a 24% gain in total revenues, while profits quadrupled to $418 million for these institutionally-oriented firms.

The following Trends analysis relies upon the NYSE member firms' domestic broker-dealer quarterly Financial and Operational Combined Uniform Single (FOCUS) Reports to the Exchange.

PROFITABILITY

The post-crash period has undoubtedly been one of the roughest times for broker-dealers, particularly for those in the retail business. But it comes on the heels of a decade of fantastic growth. For instance, from 1980 through 1986, revenues more than tripled from $16 billion to $50 billion, before remaining flat over the next two years. Likewise, expenses tripled through 1986 but didn't remain flat thereafter, squeezing profitability over the past two years (Exhibit 1).

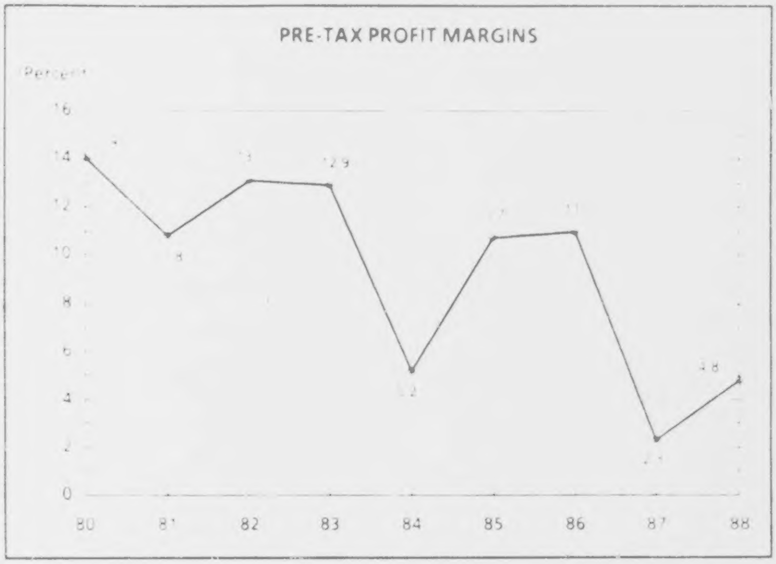
EXHIBIT 1



DOMESTIC BROKER-DEALER
REVENUES/EXPENSES/PROFITS

Prior to 1986, however, profit pressures were already underway as evidenced by the downward trend of pre-tax profit margins (Exhibit 2).

EXHIBIT 2



PRE-TAX PROFIT MARGINS

Likewise, return on equity has also been tracking steadily downward. Large equity infusions during the Eighties, from firms going public or seeking foreign and domestic partners, built up the capital base to support expanded businesses, particularly principal business lines. However, these volatile areas can generate sizable losses as well as gains. Spreads also narrowed in many business lines as firms, scrambling for revenues, all actively chased a finite amount of business. As Exhibit 3 shows, broker-dealers' pre-tax ROE fell from 50% in 1980 to under 10% last year, and as shown later, was even lower for retail firms.

EXHIBIT 3

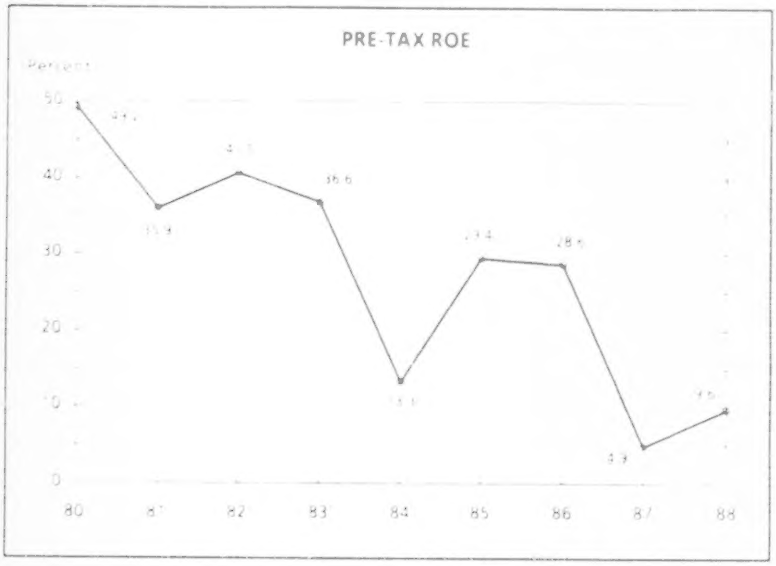
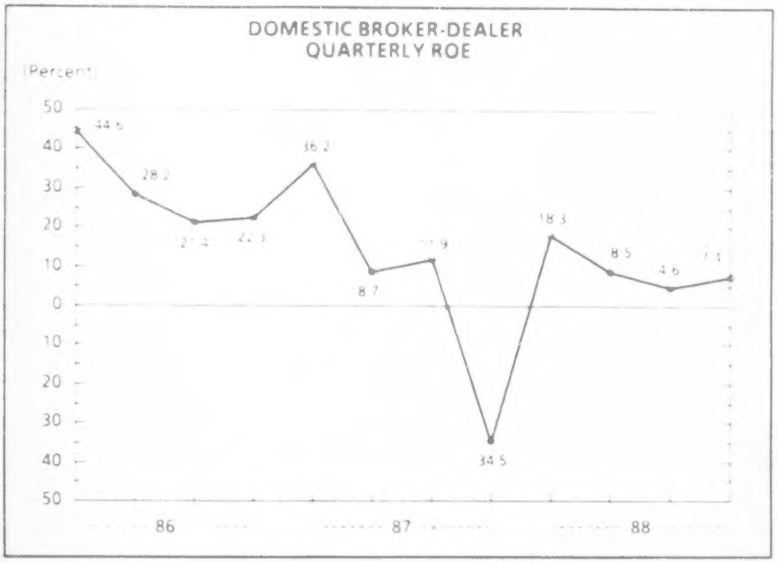


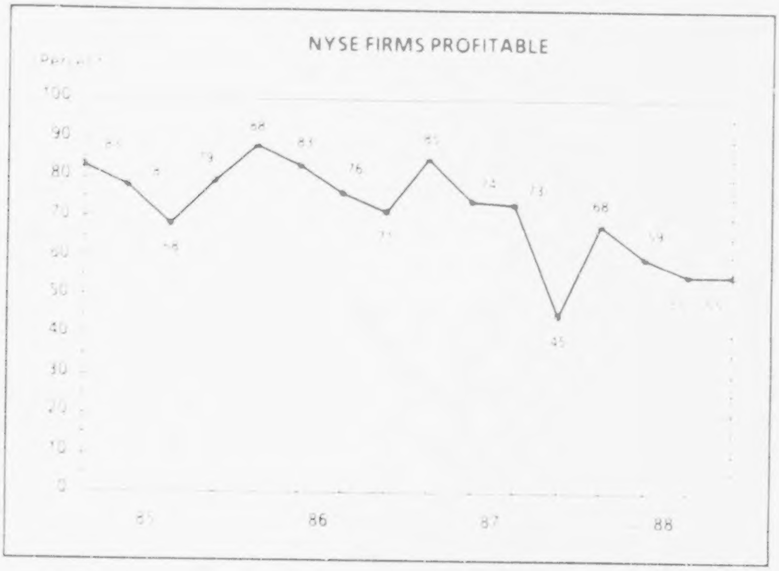
EXHIBIT 4



Looking at broker-dealer ROE quarterly since 1986 shows an unpleasant picture (Exhibit 4). ROE in 86:Q2 was only half the level of first quarter results. By mid-1987, it was halved again to around 10°o and has been hovering below that level for the past three quarters.

As recently as 1986, about 70°o to 90°o of the NYSE member firms were profitable each quarter (Exhibit 5). During crash impacted 87:Q4, less than half the firms were profitable and in recent quarters, only 55°o of the firms were in the black.

EXHIBIT 5



REVENUES

In 1988, domestic broker-dealer revenues increased $1 billion to $51.8 billion, or 2°o (Exhibit 6). But this 2% gain is net of some very steep increases and decreases in individual business lines. Trading gains and investments for the firms' own accounts each increased $1.3 billion in 1988. The biggest gains, however, came from the M&A boom and net interest revenue which are reflected in the "other securities related" FOCUS revenue line. This line shot up $3 billion or 26°o. Of that total, more than 90°o, or $2.8 billion, came from the LIBs alone. If not for the Shearson Hutton merger, however, LIBs would probably account for a lesser, but still substantial, 70°o of the growth in these businesses.

COMMISSIONS

Commission revenues, on the other hand, fell nearly $4 billion in 1988 or over 30°o. Similarly, the value of trading on the NYSE (the source of 75% of all commission revenue) fell 27°o last year. In 1987, the average daily value of equities traded on the Big Board was $7.4 billion. This fell to to $5.4 billion per day in 1988. In other words, last year, about $2 billion less in stock per day were traded on the NYSE.

EXHIBIT 6

STATEMENT OF INCOME
DOMESTIC BROKER-DEALERS

(In $ Millions)

Revenues	1987	1988	% Change
Commissions	12,646.4	8,784.1	(30.5)
Trading Profits	9,972.5	11,293.2	13.2
Investment Gains	67.8	1,391.9	NM
Underwriting	5,156.8	5,158.0	0.0
Margin Interest	3,352.3	3,028.6	(9.7)
Mutual Fund Sales	2,208.8	1,414.4	(36.0)
Fees, Account Supervision	1,811.5	1,888.6	4.3
Research	24.4	23.1	(5.3)
Commodities	1,093.4	1,378.7	26.1
Other Securities Related	11,680.4	14,702.6	25.9
Other Unrelated	2,798.5	2,761.6	(1.3)
Total Revenues	50,811.0	51,824.7	2.0
Expenses			
RR Compensation	9,335.1	7,582.0	(18.8)
Clerical Compensation	9,079.6	9,282.9	2.2
Partner Officer Comp.	1,508.1	1,337.7	(11.3)
Other Employee Comp.	630.7	527.8	(16.3)
Floor (Commission Clearing)	2,188.3	1,754.3	(19.8)
Communications	2,555.7	2,549.5	(0.2)
Occupancy & Equipment	2,729.3	3,052.9	11.9
Promotional Costs	1,203.1	1,003.2	(16.6)
Interest Expense	14,271.3	16,310.8	14.3
Errors Bad Debts	1,142.9	438.1	(61.7)
EDP	759.5	737.1	(2.9)
Non-Recurring Charges	99.5	56.1	(43.6)
Regulatory Fees	328.0	371.6	13.3
Other	3,806.3	4,330.8	13.8
Total Expenses	49,638.9	49,335.0	(0.6)
Pre-Tax Net Income	1,172.1	2,489.7	112.4

EXHIBIT 7

STATEMENT OF INCOME
DOMESTIC BROKER-DEALERS

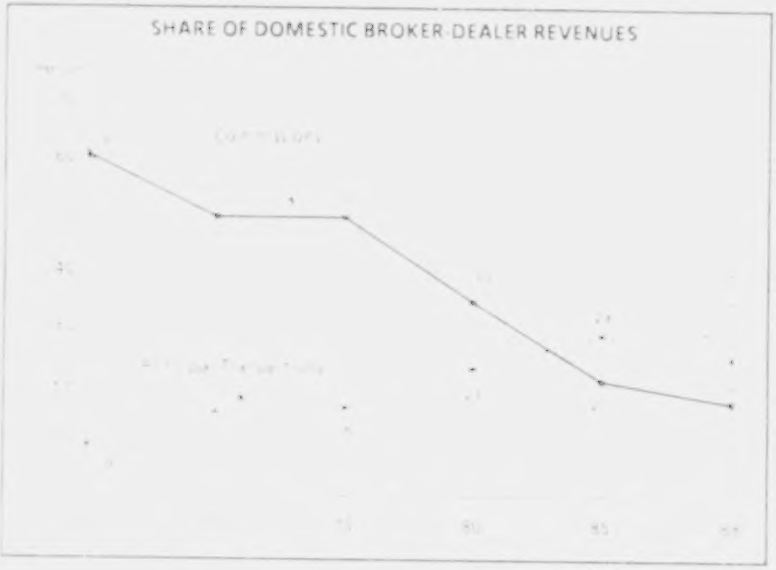
(In Percent)

Revenues	1987	1988
Commissions	24.9	16.9
Trading Profits	19.6	21.8
Investment Gains	0.1	2.7
Underwriting	10.1	10.0
Margin Interest	6.6	5.8
Mutual Fund Sales	4.3	2.7
Fees, Account Supervision	3.6	3.6
Commodities	2.2	2.7
Other Securities Related	23.0	28.4
Other Unrelated	5.5	5.3
Total Revenues	100.0	100.0
Expenses		
RR Compensation	18.4	14.6
Clerical Compensation	17.9	17.9
Partner Officer Comp.	3.0	2.6
Other Employee Comp.	1.2	1.0
Floor (Commission Clearing)	4.3	3.4
Communications	5.0	4.9
Occupancy & Equipment	5.4	5.9
Promotional Costs	2.4	1.9
Interest Expense	28.1	31.5
Errors Bad Debts	2.2	0.8
EDP	1.5	1.4
Non-Recurring Charges	0.2	0.1
Regulatory Fees	0.6	0.7
Other	7.5	8.4
Total Expenses	97.7	95.2
Pre-Tax Net Income	2.3	4.8

There has been some pick-up in equity activity in 1988, but it's becoming harder for firms to earn a profit in this area. The 1989 increased activity and market levels are helping investors make a profit. But due to pricing pressures, securities firms aren't making much, if any, profit on this activity.

The drop in commissions was felt equally by investment banking and retail firms. LIBs, NFLs, NYCs, Regionals and Discounters all had about 30% drops in their commission revenues (Appendix A). Until last year, commissions generally rose year-to-year, doubling from $5.7 billion for all NYSE firms in 1980 to a record $12.6 billion in 1987, before 1988's 30% drop. As painful as this drop was, the previous growth in aggregate commissions masked the long-term downward trend in commissions' relative importance to total revenues.

EXHIBIT 8



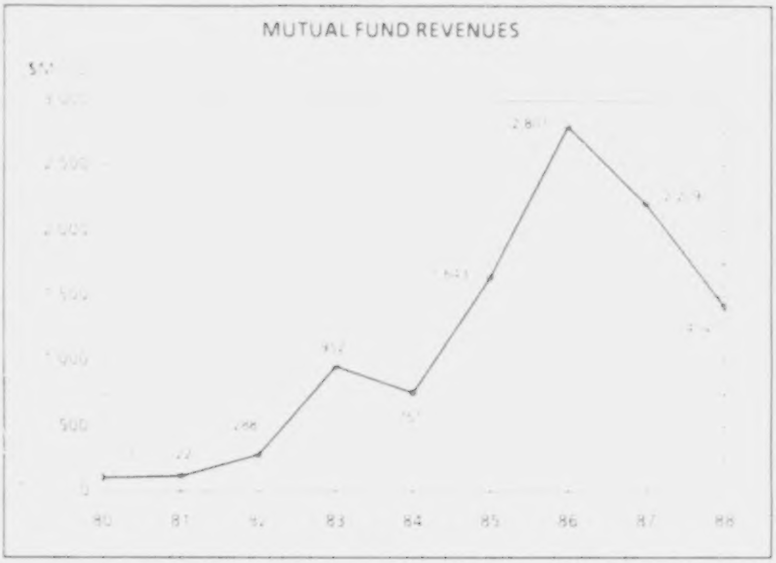
SHARE OF DOMESTIC BROKER-DEALER REVENUES

As Exhibit 8 depicts, commissions accounted for over 60% of broker-dealer revenues a decade prior to May Day. By last year, commissions accounted for just under 17% of total revenues. Principal transactions (trading and investment gains) rose from under 10% of revenues in the Sixties to 30% by 1985. Last year, this percentage fell to 25% of all revenues despite a $2.7 billion increase in 1988 trading and investment gains, mainly because of exceptional growth in other capital market areas, particularly M&A fees and interest income. If the other capital market revenues such as underwriting and "other related" are added to principal transactions, the 1988 total comes to $32.5 billion, or nearly two-thirds of NYSE broker-dealer revenues (Exhibit 7).

MUTUAL FUNDS

The phenomenal growth of the retail "success" of the Eighties, mutual funds, came not only to a screeching halt with the crash, but in just two years, these revenues have been slashed in half (Exhibit 9).

EXHIBIT 9



The NFLs account for almost all of the NYSE broker-dealer mutual fund revenues -- $1.1 billion of last year's $1.4 billion total -- and thus mirror the overall decline. But the Regional firms, with lesser aggregates but more commission-dependent, were harder hit. They produced only $259 million from this source last year, down 52% from 1987 and less than two-fifths of the record $660 million they generated in 1986.

Mutual funds, which accounted for 13.3% of Regionals' 1986 revenues, also fell to two-fifths of their 1986 levels last year and accounted for just 6.2% of Regionals' revenues in 1988.

Another retail service which grew side by side with mutual funds (and also attracted a large amount of funds away from traditional deposit accounts), was the money market fund, together with automatic cash sweeps (into these funds) often tied to retail brokerage accounts today. These products were an unqualified success in bringing in business (asset gathering) and generating revenues but the flip side was a shrinkage of the percent of customer funds on which firms do not pay interest.

Since these balances are largely used to finance margin lending, brokerages have had to seek alternate, more costly sources of funds to finance this business. Unlike any other revenue source, margin interest revenues remained basically flat throughout the Eighties, and less a contributor to the growing revenue base. In 1980, 1982 and 1983, these revenues totaled $2 billion each year. For 1981 and during 1984-88, it totaled $3 billion annually. Total revenues, meanwhile, tripled from $16 billion in 1980 to $52 billion last year.

MARGIN INTEREST

Though margin interest has been flat, margin debt has not. Margin debt balances, averaging around $10 billion outstanding in 1980, steadily rose until just prior to October 1987. During that time span, these borrowings quadrupled, peaking at $44 billion in September 1987 (but averaging $38 billion for the year). Since then, the debt outstanding has averaged about $33 billion. According to Sanford C. Bernstein estimates, currently 60% to 70% of credit balances are interest bearing. With the disappearance of truly "free" credits, firms must now use alternative financing sources, such as the repo market, with a resultant higher interest expense.

In addition, interest rates over the same time frame basically headed downward (until last year), reducing the rate brokerages earned on margin debt outstanding. Also, the returns on margin lending are down. From 1980 to 1982, margin interest revenues averaged about 20% of margin debt outstanding, but only 10% for the past six years.

Over half of the NYSE broker-dealers' margin interest revenues are booked at the NFLs. NFLs' margin interest revenues have fallen from 20% of total revenues in 1981 to just 8% last year. Margin interest contributed a similar 19% to Regionals' total revenues in 1981 -- last year it accounted for only 7%. For the NYCs, margin interest fell from 19% to 3% of total revenues over the same seven years.

TRADING GAINS

Trading gains, principally from bonds, made a comeback last year, rising 13% to $11.3 billion, or 22% of total revenues (Exhibit 7). That's still below 1986's record highs and the 25% trading contributed to total revenues from 1982 to 1986. In 1987, major bond trading losses led to a 20% drop in these revenues: falling from 1986's $12.6 billion to 1987's $10.0 billion.

Throughout the Eighties, bond trading ranged from 65% to 75% of all trading gains. Last year, bonds' percentage of total trading gains bounced back up to 73% from 87's 68%, indicating investor activity shifting back to fixed income from equities.

Nearly half the NYSE broker-dealers' trading gains are booked by the NFLs. Last year, the NFLs' trading profits rose 16% to $5.1 billion from 1987's $4.4 billion, and very close to their 1986 record $5.5 billion.

Most of the balance of trading results are logged at the LIBs and the NYCs. The LIBs' $3.9 billion of 1988 trading gains held even with 1987's and 1985's results and was second only to their 1986 record $5.2 billion. For the LIBs, throughout the Eighties, a higher 75% to 80% of their gains were attributable to bond trading. Last year, this percentage rose to a record 85%, underlying the heavy focus on fixed income by institutional investors last year.

The NYCs posted a 70% increase in trading profits last year to a record $1.1 billion. Although a record in dollar amount, trading still accounted for 18% to 19% of NYCs' revenues in both 1986 and 1988. Meanwhile, Regionals' 1988 trading gain of $880 million was up a slight 7% from 1987's results.

INVESTMENT GAINS

Investments for firms' own accounts reached a record $1.4 billion last year. In 1985 and 1986, the record levels being set were $1.1 billion annually before 1987's disastrous drop to nearly zero (due to a $1.3 billion investment loss in 87:Q4). The bounce-back in investment gains, moreover, was universal, extending to all categories of firms.

The NFLs went from a 1987 loss of $82 million in investments to a 1988 gain of $186 million. LIBs' 1987 gain of $95 million was tripled to $288 million last year. The NYCs went from investment losses of $77 million in 1987 to gains of $354 million last year while Regionals showed a 35% increase in these gains in 1988 to $51 million.

UNDERWRITING

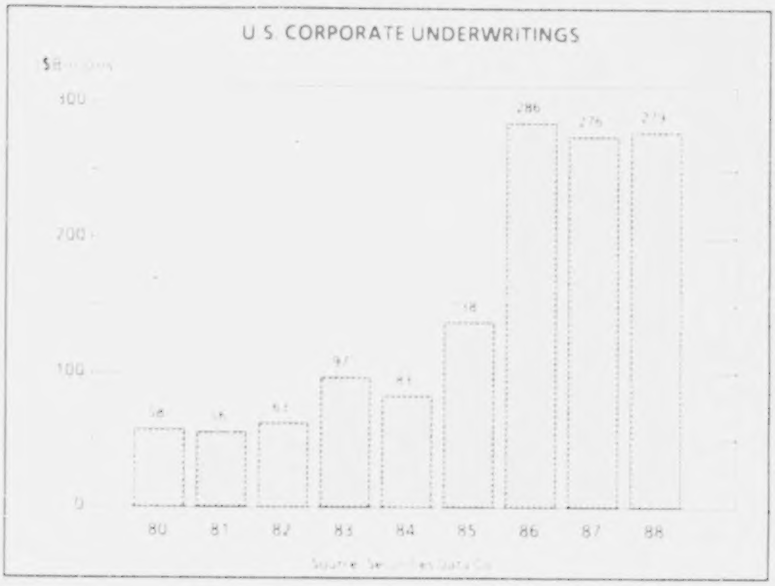
Domestic underwriting revenues have been holding their own at $5.2 billion for the past two years although high yield and M&A related bond financings were last year's profit source vs. the equity underwriting bonanzas of 1985 and 1986. Their absence led to a 1987 and 1988 underwriting revenues sitting at 12% below 1986's record $5.9 billion, but these were still the two second best years.

Underwriting, particularly corporate underwriting, is a very concentrated business line in the securities industry. Almost all products underwritten are dominated by a handful of firms although about 300 firms participate to some measurable extent in the corporate and municipal primary markets.

The bulk of underwriting activity and revenues are attributable to two main firm categories: NFLs and LIBs. The LIBs' underwriting revenues have been holding steady the past three years at just under $2 billion annually. The LIBs, meanwhile, have captured a larger share of total underwriting revenues over the Eighties, climbing from 25% of industry underwriting revenues in the early 1980s to about 35% the past few years. This increase wasn't at the expense of the NFLs, however, which have maintained their 50% share of industry underwriting revenues throughout the Eighties.

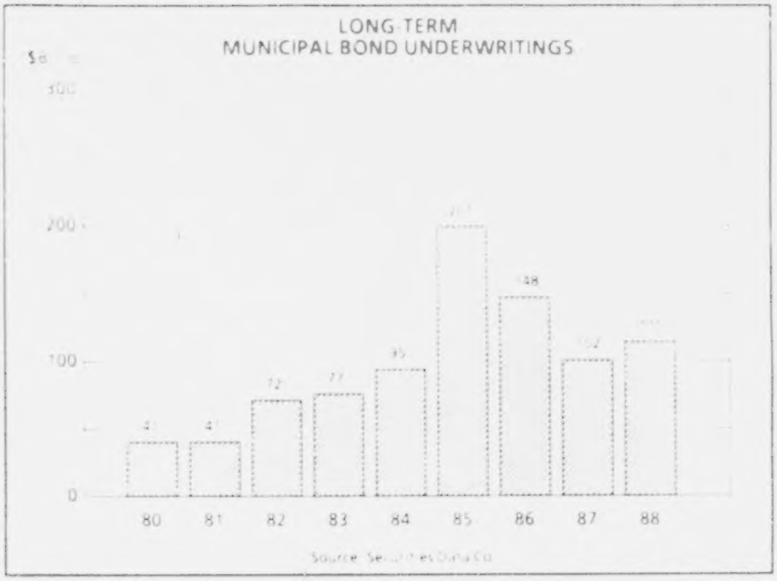
Having a combined 85% of the market, it's not surprising that the steady level of $2 billion in underwriting fees for the LIBs and about $2.5 billion for the NFLs tracks well with the volume of total corporate underwritings (Exhibit 10). Municipal underwriting volume has trailed off since the Tax Reform Act of 1986 (Exhibit 11) and industry leaders in this field have been curtailing and abandoning this field (including NFL and LIB firms). Fortunately, these lost fees have been mostly offset by the growth of higher-fee corporate underwritings over the past few years.

EXHIBIT 10



Source: Securities Data Co.

EXHIBIT 11



Source: Securities Data Co.

Regional firms, originally stung by the advent of SEC Rule 415 and the subsequent growth of non-syndicated deals, have fallen on further hard times in their underwriting business. Their 1988 underwriting revenues of $541 million were down 14% from 1987 and were the lowest level in four years. The absence of equity issues and municipal bonds, where Regionals have an underwriting presence, hurt this performance. Regionals also did not benefit from the fixed income underwriting growth of asset-backed and high yield bonds which are dominated by a few large firms.

By 1986, the NYCs reached a record $185 million in underwriting revenues, but two years later this revenue source was cut by more than half to just $80 million. Again, though total corporate underwriting volume remained steady over these years, the recent totals were fueled by asset-backed and high-yield bonds which are not the main underwriting products for this group.

OTHER SECURITIES RELATED REVENUES

The biggest revenue gains for NYSE broker-dealers came from the "other securities related" FOCUS revenue line which shot up $3 billion, or 26%, last year. Of that total, more than 90%, or $2.8 billion, came from the LIBs alone. This line is a catch-all for several business areas but the bulk of the revenues consist of M&A related fees, private placement fees and interest income from the repo businesses. Precisely how much each area contributes to the total is not broken out but in 1988 we estimate that the majority of the growth came from the M&A and repo areas.

M&A

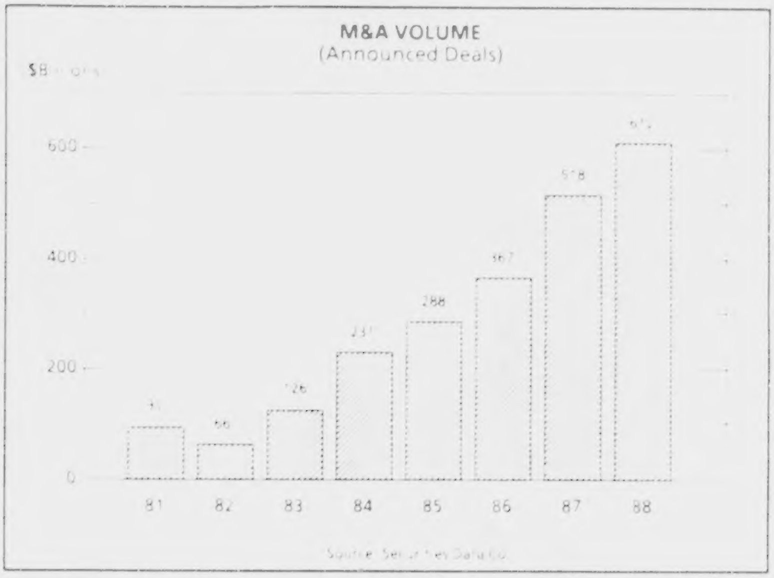
The LIBs, as well as the NFLs, command the bulk of the M&A-related business in the U.S. as well as most of the megadeals. But, due to the Shearson Hutton merger, NFLs' "securities related" revenues dropped by $600 million in 1988; otherwise, we estimate that this line would have increased by about $4 billion, or 34%, leaving the LIBs with about a 70% share. The NYCs also experienced a $900 million, or 65%, increase in this area.

Regionals' "other related" revenues broke through the half-billion dollar mark for the second straight year to a record $546 million. Combined with their principal transaction performance, it shows the Regionals are also following the industry trend of placing more capital in use for their own deals which seems to be the only profit game in town -- albeit a higher stakes game.

For all NYSE broker-dealers, "other related revenues" have increased 8.5-fold since 1980, climbing from $1.7 billion to $14.7 billion last year. Since a major amount of this revenue comes from M&A fees, it's not surprising that Exhibit 12's depiction of the growth in M&A volume closely parallels this revenue line. However, first quarter 1989 preliminary indications show some softening in the M&A boom but by no means an end to it.

Also, this revenue line has nearly tripled in importance to securities firms' total revenues during the Eighties. In 1980, "other related" revenues accounted for 10.8% of all NYSE broker-dealers' revenues -- last year this reached a record 28.4%, the single largest revenue source (if this "catch-all" line can be considered a single source).

EXHIBIT 12



Source: Securities Data Co.

This growth has been felt by all categories of securities firms but is nowhere more important than for the LIBs (although the NYCs are beginning to mirror the LIBs' growth in this area). Last year, LIBs' "other related" revenues reached a record $7.5 billion, up 59% from 1987's previous $4.7 billion record! Further, this line now accounts for a full 44.1% of the LIBs' total revenue, a drastic increase from 18% in 1980.

The LIBs also account for half of the revenue from these sources (M&A, private placements and repo activity), and thus drive the overall growth patterns in this area. The NFLs historically trailed the LIBs only slightly in this area (with 36% of the total), but last year they fell to just 25% of all revenues from these sources (again, mainly due to the loss of Hutton). The NYCs had fantastic growth of "other related" revenue, mainly from repo business and M&A merchant banking work. Here, 1988 revenues shot up 65% to a record $2.2 billion, or a whopping 40% of the NYCs' total revenue base.

REPOS

Besides M&A, the large increase in "other securities related" revenues has come from the growth of firms' repo and reverse repo transactions and inventory last year. For the NYSE firms, both repo and reverse repos outstanding were up about $50 billion from 1987 levels, or 25%. According to the Federal Reserve, all government securities dealers increased their repo activity 26% last year or by $70 billion and their reverse repo activity by $100 billion or over one-third. The securities firms with primary dealer status are concentrated in the NFLs, LIBs and NYCs. Also, as rates were rising in 1988, firms' interest earnings on their corporate and government repo book should have increased even without an increase in their positions.

For the LIBs, their repo and reverse repo inventories were also up 25% or by about $30 billion on average last year, which, when combined with their heavy M&A fees in 1988, led to their 59%, or $2.8 billion increase in "other related" revenues.

The closing of Hutton's repo book in 87:Q4 was by far the bulk of the $18 billion drop in NFLs' repo and reverse repo inventory which also was the main cause of the NFLs' 14%, or $600 million, drop in "other securities related" revenue. The drop in NFLs' interest income is actually larger than $600 million since NFLs had significant increases in M&A fees last year (which are combined with interest in this FOCUS line).

Heavy emphasis on the repo business by the NYCs led to a $1 billion increase in their "other related" revenues, one-third of the NYSE firms' increase. The NYCs' inventory of repos and reverse repos doubled in 1988 to nearly $50 billion each.

EXPENSES

Broker-dealers increased their repo book on both sides of the balance sheet last year (by $50 billion each or 25%) with a counterbalance to the boom in interest revenue -- increased interest expense. Total interest expense last year increased by $2 billion or 14%, also fueled by higher interest rates.

This trend had a major impact on the LIBs since their single largest and fastest increasing expense line is interest. The LIBs had a $30 billion, or 25%, increase in their repo and reverse repo inventories last year and a corresponding $2 billion, or 29%, increase in their interest cost. At $8.7 billion, interest expense ate up just over half of the LIBs' revenues and accounted for a full 55% of total expenses.

The NYCs had the biggest increase of all firm categories in their repo and reverse repo inventory -- it doubled. They also had the largest percentage increase in interest expense last year. Interest costs shot up 65% to a record $2.5 billion. For the NYCs, interest now accounts for just about half of all expenses, close to the LIBs' interest ratio.

The closing of Hutton's repo book slashed the NFLs' repo and reverse repo inventory and led to an $800 million, or 18%, decline in interest expense (which otherwise would have risen during 1988's rising rate environment). In 1988, all of the publicly held NFL firms had higher interest revenues and expenses in their consolidated financial reports. This drop in interest cost was also half of the total drop in NFL expenses in 1988, inflating their overall cost cutting picture.

COMPENSATION

The single largest expense for broker-dealers (second largest for LIBs and NYCs) is compensation costs. A main component of this cost is broker compensation which fell $1.8 billion last year. From a profitability standpoint, that's a movement in the right direction. Though RR compensation fell $1.8 billion, or 19%, commission revenues fell more than twice as far, down $3.9 billion or 31%. Additionally, nearly 9,000 registered representatives, or 9% of all RRs, have left the NYSE broker-dealers since the October crash. But, since nearly 5,000 of these brokers departed during 1988 (1,000 during the second half), some of the cost savings will not be reflected fully until early 1989.

Still, at a level of only 14.6% of revenues last year, RR comp is consuming by far the smallest portion of total revenues since data was first available in the 70s and probably the lowest level ever! During the previous 12 years, RR comp averaged 18% of total revenue and never averaged less than 16.8%.

More troubling is the continuous rise in clerical and administrative employee compensation expense to record levels. Despite a 9% cutback in the non-producer workforce since the crash (or nearly 15,000 positions), this expense item increased over 2% again last year to $9.3 billion. For the second straight year, clerical comp is still consuming a record 17.9% of total revenues despite announced plans to reduce these costs.

One reason may be that with many of the high-paid "non-RR" talent being reported here (i.e. M&A, corporate finance non-RR pros), their growth combined with the cutbacks in operations and clerical staff would leave a higher concentration of higher paid people in this expense line. Since that information is not available, total compensation may be a better measure.

Combining all direct payroll lines, total payroll expense fell $1.8 billion last year, or 9%. That matches the 9% reduction in the NYSE broker-dealers' workforce since the crash. At $18.7 billion, this is the lowest payroll since 1985. Additionally, payroll accounted for just 36.1% of total revenues in 1988, the lowest percentage this decade and down dramatically from the previous year's 40.5%. Viewed in this perspective, the industry appears to be addressing some of its compensation problems. Further reductions should be seen in 1989 from previous cuts and with further reductions already underway in 89:Q2.

EXHIBIT 13

EMPLOYEES

(in Thousands, End of Period)

Firm Category	80	81	82	83	84	85	86	87	88
National Full Line	81.0	92.9	100.3	112.6	122.5	127.5	143.4	146.4	135.2
Lg. Investment Banks	15.8	17.8	19.9	23.9	25.1	27.0	33.5	38.1	33.5
Regionals	N.A	31.2	31.5	34.3	36.2	35.6	39.2	42.2	37.7
New York City Based	N.A	10.9	10.9	11.2	11.7	12.4	13.3	16.0	16.3
NYSE Discounters	N.A	0.6	1.2	1.6	2.1	2.7	3.8	5.0	4.3
All NYSE Firms	**139.8**	**160.6**	**171.0**	**192.0**	**207.5**	**214.6**	**244.1**	**260.5**	**238.6**

OTHER EXPENSES

One expense that has not been curtailed during these tough times is occupancy and equipment costs which rose 12% in 1988, breaking through the $3 billion barrier. O&E costs ate into a record 6% of total revenues last year. This "fixed" cost has been on the rise for quite some time, rising six-fold since 1980 and now eating up nearly twice the percentage of total revenue than in 1980. These "fixed" costs are not easily cut overnight.

Some firms have locked themselves into higher occupancy costs from pre-crash headquarter moves and expansion plans, while others took one time charges from cancelling such planned moves or building programs. Still, these cost increases were across the board for all firm categories.

However, published reports indicate that firms are now taking advantage of expiring leases and consolidating some branch offices. Therefore, 1989 may show some curtailment of this cost.

Fortunately, cost cutting measures did result in reduced expenses for almost every other expense item: communications, data processing, promotional and advertising, and floor brokerage expenses all fell in 1988. There are also indications that management is targeting further reductions in these costs for 1989.

SUMMARY

The retail business has been dormant since October 1987. Those firms concentrating in the capital markets, particularly M&A, merchant banking, principal trading, high yield financings, etc., have fared much better. Rising interest rates, however, have hurt these firms since their profits are very interest sensitive.

LIBs doubled their profit margin to 8.4%, the best of all firm categories (Exhibit 14). But at this level, it is still only second to 1987 for their worst profit margin in a decade. Similarly, the LIBs' return on equity doubled last year also to 18%, again the best, but still second only to 1987 for the LIBs' smallest return in a decade (Exhibit 15).

EXHIBIT 14

PRE-TAX PROFIT MARGINS

(In Percent)

Firm Category	80	81	82	83	84	85	86	87	88
National Full Line	10.9	6.9	8.8	8.6	(0.9)	5.6	6.9	(0.9)	(0.3)
Lg. Investment Banks	17.7	15.4	17.4	16.7	11.4	14.6	13.5	4.7	8.4
Regionals	14.7	11.2	11.1	12.6	2.6	9.4	11.0	5.5	2.6
New York City Based	14.8	12.6	14.0	18.3	8.9	12.3	16.1	2.2	7.4
NYSE Discounters	17.5	12.2	13.6	14.0	0.3	8.9	15.7	8.6	3.1
All NYSE Firms	**14.1**	**10.8**	**13.1**	**12.9**	**5.2**	**10.7**	**11.0**	**2.3**	**4.8**

EXHIBIT 15

PRE-TAX RETURN ON EQUITY

(In Percent)

Firm Category	80	81	82	83	84	85	86	87	88
National Full Line	45.0	24.6	29.8	28.1	(2.6)	17.9	20.3	(2.1)	(0.7)
Lg.Investment Banks	55.7	56.7	54.8	43.8	31.1	38.5	34.2	9.3	18.2
Regionals	N.A	37.2	36.0	40.5	6.8	29.0	32.7	14.1	5.4
New York City Based	N.A	42.1	43.3	50.7	19.9	31.2	38.3	3.9	15.0
NYSE Discounters	N.A	52.2	53.9	46.7	0.8	25.6	49.5	19.7	5.0
All NYSE Firms	**49.2**	**35.9**	**40.5**	**36.6**	**13.3**	**29.4**	**28.6**	**4.9**	**9.6**

The NYCs also enjoyed growth in non-retail business lines for a 24% increase in total revenues. Costs, led by a $1 billion spike in interest expense, also climbed but by a much smaller 17% for a quadrupling of profits to $418 million. That is still $200 million short of the NYCs' 1986 record profits. With most other firms struggling last year, this allowed the NYCs to capture a record 17% of NYSE firm profits, a much higher proportion than their 11% share of revenues.

The retail-oriented NFLs lost money in their broker-dealer units for the second straight year or for the third time in the past five years. Their total revenues fell 7% in 1988 while expenses were trimmed slightly more, 7.5%, producing a slightly smaller loss than in 1987.

Regional firms, also heavily dependent on retail business, saw their profitability plunge 50% in 1987 and then plummet an even further 61% last year.

At $107 million, the Regionals' 1988 pre-tax profits were the second lowest of the Eighties (only 1984's $84 million was lower). Furthermore, Regionals' 1988 pre-tax profit margin of 5.4% was their lowest of the Eighties. As for total revenues' 15% fall to $4.2 billion, this led to the first substantial drop in Regionals' share of NYSE firms' revenues in five years, with Regionals' share now at 8% after four years at a 10% and even higher shares previously.

As for share of profits, initially the Regionals weathered the impact of the crash better than other firms in general. In 1987, they maintained their 10% share of revenues but captured 23% of (albeit small) profits. Last year, Regionals only cornered 4% of profits since most of these profits were not retail-sourced.

The most retail and commission-oriented group of firms, the Discounters, experienced a 19% drop in revenues last year but could only slash costs by a smaller 14%. This led to a dramatic 71% drop in pre-tax profits to a mere $31 million in 1988.

The Discounters' pre-tax profit margin of 3.1% last year and ROE of 5.0% were the lowest of the NYSE group's, excluding the NFLs' broker-dealer losses, and the Discounters' worst showing since 1984.

What needs to be seen this year are further cost savings from measures carried out in 1988 and early 1989. Compensation should be reduced further; occupancy and equipment costs should fall or at least level out; management controls should prevent further huge trading losses; hopefully, recovering markets should lead to higher equity-related revenues and bring to fruition some previous merchant banking deals.

Initial Q1 results from publicly held firms indicate that commissions will rebound but principal transactions and investment banking revenues will be down. Compensation and total expenses should show a nice downward movement but occupancy costs probably will not be dented yet. And as for profitability, the initial reports of publicly held firms suggest continued disappointment for the retail firms: NFLs and Regionals may show no improvements and possible further deteriorations. The softer capital market areas may sharply reduce profits for the LIBs. However, the year has only begun and a market recovery is as inevitable as taxes -- it's just a matter of timing.

EXHIBIT A-1

STATEMENT OF INCOME
NATIONAL FULL LINE FIRMS

(In $ Millions)

Revenues	1987	1988	% Change
Commissions	5,354.3	3,602.9	(32.7)
Trading Profits	4,414.0	5,118.2	16.0
Investment Gains	(82.3)	185.5	NM
Underwriting	2,475.9	2,524.7	2.0
Margin Interest	1,673.9	1,610.5	(3.8)
Mutual Fund Sales	1,579.7	1,087.6	(31.2)
Fees, Account Supervision	748.2	811.3	8.5
Commodities	792.2	781.4	(1.4)
Other Securities Related	4,232.0	3,641.6	(14.0)
Other Unrelated	495.2	800.8	61.7
Total Revenues.	21,683.2	20,167.1	(7.0)
Expenses			
RR Compensation	5,698.9	4,616.4	(19.0)
Clerical Compensation	4,606.5	4,747.5	3.1
Partner Officer Comp.	262.6	150.1	(42.8)
Floor (Commission Clearing)	560.6	428.2	(23.6)
Communications	1,493.4	1,526.7	2.2
Occupancy & Equipment	1,531.9	1,654.1	8.0
Promotional Costs	687.5	562.9	(18.1)
Interest Expense	4,576.4	3,764.4	(17.7)
Errors Bad Debts	630.1	325.3	(48.4)
EDP	252.9	243.0	(3.9)
Non-Recurring Charges	30.1	24.8	(17.6)
Regulatory Fees	170.7	221.2	29.6
Other	1,373.9	1,970.5	43.4
Total Expenses	21,875.8	20,235.3	(7.5)
Pre-Tax Net Income	(192.6)	(68.2)	NM

EXHIBIT A-2

STATEMENT OF INCOME
LARGE INVESTMENT BANKS

(In $ Millions)

Revenues	1987	1988	% Change
Commissions	1,816.1	1,159.8	(36.1)
Trading Profits	3,830.5	3,870.8	1.1
Investment Gains	95.3	287.7	201.9
Underwriting	1,814.0	1,864.4	2.8
Margin Interest	610.3	486.4	(20.3)
Mutual Fund Sales	39.7	18.2	(54.2)
Fees, Account Supervision	352.9	399.2	13.1
Research	1.0	(0.3)	(130.0)
Commodities	197.2	432.4	119.3
Other Securities Related	4,727.9	7,516.2	59.0
Other Unrelated	1,289.2	1,014.3	(21.3)
Total Revenues	14,774.2	17,049.1	15.4
Expenses			
RR Compensation	1,437.5	1,111.0	(22.7)
Clerical Compensation	2,172.0	2,357.0	8.5
Partner Officer Comp.	599.5	637.0	6.3
Floor (Commission Clearing)	478.8	464.6	(3.0)
Communications	444.5	410.4	(7.7)
Occupancy & Equipment	554.6	655.5	18.2
Promotional Costs	241.3	193.5	(19.8)
Interest Expense	6,735.8	8,655.3	28.5
Errors Bad Debts	168.8	19.0	(88.7)
EDP	253.7	267.5	5.4
Non-Recurring Charges	59.2	11.5	(80.6)
Regulatory Fees	41.4	38.4	(7.2)
Other	894.9	795.5	(11.1)
Total Expenses	14,081.6	15,616.1	10.9
Pre-Tax Net Income	692.6	1,433.0	106.9

EXHIBIT A-3

STATEMENT OF INCOME
REGIONAL FIRMS

(In $ Millions)

Revenues	1987	1988	% Change
Commissions	1,813.0	1,324.8	(26.9)
Trading Profits	819.8	879.5	7.3
Investment Gains	37.3	50.5	35.4
Underwriting	629.2	541.4	(14.0)
Margin Interest	314.0	294.1	(6.3)
Mutual Fund Sales	533.3	258.9	(51.5)
Fees, Account Supervision	107.8	113.0	4.8
Research	10.2	13.2	29.4
Commodities	48.9	49.0	0.2
Other Securities Related	531.7	546.2	2.7
Other Unrelated	117.1	131.0	11.9
Total Revenues	4,960.7	4,201.7	(15.3)
Expenses			
RR Compensation	1,405.7	1,056.9	(24.8)
Clerical Compensation	915.1	831.9	(9.1)
Partner Officer Comp.	313.6	245.6	(21.7)
Other Compensation	139.1	164.1	18.0
Floor (Commission Clearing)	230.4	173.1	(24.9)
Communications	327.9	315.5	(3.8)
Occupancy & Equipment	267.4	284.1	6.2
Promotional Costs	137.6	121.2	(11.9)
Interest Expense	396.7	412.0	3.9
Error Bad Debts	83.4	29.5	(64.6)
EDP	82.5	75.5	(8.5)
Non-Recurring Charges	2.0	4.5	125.0
Regulatory Fees	43.4	41.8	(3.7)
Other	341.6	339.0	(0.8)
Total Expenses	4,688.1	4,094.5	(12.7)
Pre-Tax Net Income	272.6	107.2	(60.7)

EXHIBIT A-4

STATEMENT OF INCOME
NEW YORK CITY-BASED FIRMS

(In $ Millions)

Revenues	1987	1988	% Change
Commissions	1,561.5	1,076.8	(31.0)
Trading Profits	621.0	1,059.0	70.5
Investment Gains	(77.3)	354.1	NM
Underwriting	116.9	80.4	(31.2)
Margin Interest	207.8	174.7	(15.9)
Mutual Fund Sales	37.6	26.7	(29.0)
Fees, Account Supervision	339.4	338.5	(0.3)
Research	5.1	2.2	(56.9)
Commodities	11.8	36.8	211.9
Other Securities Related	1,340.4	2,214.4	65.2
Other Unrelated	372.1	267.7	(28.1)
Total Revenues	4,536.6	5,631.1	24.1
Expenses			
RR Compensation	527.3	554.1	5.1
Clerical Compensation	743.7	695.4	(6.5)
Partner Officer Comp.	150.7	138.1	(8.4)
Other Compensation	210.8	83.3	(60.5)
Floor (Commission Clearing)	325.9	237.4	(27.2)
Communications	145.0	156.1	7.7
Occupancy & Equipment	178.0	234.8	31.9
Promotional Costs	75.9	77.3	1.8
Interest Expense	1,503.6	2,468.8	64.2
Error Bad Debts	28.9	18.7	(35.3)
EDP	58.1	58.6	0.9
Non-Recurring Charges	7.8	9.9	26.9
Regulatory Fees	31.1	31.7	1.9
Other	451.8	448.1	(0.8)
Total Expenses	4,438.6	5,212.9	17.4
Pre-Tax Net Income	98.0	418.2	326.7

EXHIBIT A-5

STATEMENT OF INCOME NYSE DISCOUNTERS

(In $ Millions)

Revenues	1987	1988	% Change
Commissions	717.5	481.6	(32.9)
Trading Profits	5.5	6.5	18.2
Investment Gains	(0.7)	7.1	NM
Margin Interest	192.4	179.9	(6.5)
Mutual Fund Sales	11.4	13.3	16.7
All Other	304.3	305.6	0.4
Total Revenues	1,230.4	994.0	(19.2)
Expenses			
RR Compensation	28.1	34.4	22.4
Clerical Compensation	140.4	133.7	(4.8)
Partner Officer Comp.	21.8	14.4	(33.9)
Other Compensation	117.6	92.6	(21.3)
Floor (Commission Clearing)	171.0	106.4	(37.8)
Communications	52.9	50.8	(4.0)
Occupancy & Equipment	58.5	73.6	25.8
Promotional Costs	29.9	21.1	(29.4)
Interest Expense	167.1	212.0	26.9
Error Bad Debts Non-Recurring	66.9	10.0	(85.1)
EDP	55.6	28.2	(49.3)
Regulatory Fees	4.3	5.5	27.9
Other	210.7	180.5	(14.3)
Total Expenses	1,124.9	963.2	(14.4)
Pre-Tax Net Income	105.5	30.8	(70.8)

VOLUME

	MAR 1989	YTD 1989	MAR 1988	YTD 1988	% CHG YTD 1989-1988
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	159.2	165.6	176.2	178.6	7.3%
AMEX (MILS.)*	12.2	11.9	12.4	10.8	10.5%
NASDAQ (MILS.)*	131.1	131.2	137.3	128.6	2.0%
REGIONAL EXCHANGE (MILS.)*	N/A	N/A	24.9	25.0	N/A
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$123,290	$359,498	$134,828	$371,533	-3.2%
AMEX (MILS.)	2,951	7,612	3,681	8,432	-9.7%
ODD LOT SHARES PURCHASED ON NYSE (THOUS.)	8,386	25,823	8,093	22,552	14.5%
ODD LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	16,901	50,337	18,027	44,783	12.4%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	53.4%	52.8%	52.8%	53.6%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	10,517	32,198	9,850	27,130	18.7%
AMEX OPTIONS	3,440	10,005	3,841	9,505	5.3%
COMMODITY	23,691	67,108	20,636	58,578	14.6%

*MONTHLY AVERAGE
N/A DATA NOT AVAILABLE

PRICES
(END OF MONTH)

	MAR 1989	MAR 1988	% CHG MAR 1989-1988
DOW JONES INDUSTRIALS	2293.62	1988.06	15.37%
STANDARD & POOR S 500	294.87	258.89	13.90%
NYSE COMPOSITE	165.63	146.60	12.98%
AMEX MARKET VALUE INDEX	328.31	296.43	10.75%
VALUE LINE COMPOSITE	245.77	228.14	7.73%
NASD/Q COMPOSITE	406.73	374.64	8.57%

YIELDS
(MONTHLY AVERAGES)

	JAN 1989	JAN 1988	BASIS POINT CHG 1989-1988
BOND BUYER INDEX (20 BOND)	7.35%	7.69%	(34)
CORPORATE BOND YIELDS (MOODY S)			
Aaa CORPORATE	9.62	9.88	(26)
Baa CORPORATE	10.65	11.07	(42)
RATIO Aaa CORPS. TO Baa CORPS.	0.90	0.89	1

UNDERWRITING

	1ST QUARTER 1989	1ST QUARTER 1988	% CHANGE 1989-1988
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$70,691.9	$67,757.2	4.3%
Common Stock	$3,911.2	$7,731.5	49.4%
# of Common Stock Issues	69	68	1.5%
Preferred Stock	$559.3	$2,260.5	75.3%
# of Preferred Stock Issues	13	38	65.8%
Corporate Debt	$66,221.3	$57,761.5	14.6%
# of Corporate Debt Issues	805	743	8.3%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$16,504.4	$18,679.5	11.6%
# of Issues	568	807	29.9%
Competitive	$6,425.7	$6,36[illegible]	1.0%
# of Issues	652	706	-7.6%

Source: IDD Information Services

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
SIA Tax Testimony	On April 13, SIA testified before the House Ways & Means Committee on the President's proposal to lower the capital gains tax rate to 15%. Using the 1978 and 1981 experience with lower capital gains rates and the relatively harsh treatment of investment income in the U.S. compared to other major countries, SIA urged Congress to improve the President's proposal and to enact a lower capital gains tax. On April 19, SIA testified before the same committee on the need to restore targeted tax savings incentives. The low U.S. savings and investment rate was compared to that of our international competitors and it was noted that almost all foreign nations use special allowances and exemptions to foster savings. SIA recommended that the tax treatment of investment income and the IRA experience be reviewed and reconsidered.	SIA Research Department
"1st Quarter Domestic Corporate Finance Rankings"	In an atmosphere marked by rising short-term interest rates and lingering event risk, many companies turned to the swap market for funds while waiting for a downturn in rates later in the year. Driven largely by swap related debt, domestic offerings rose to $70.7 billion in the first quarter, a slight improvement over $67.8 billion of stocks and bonds issued during the first three months of 1988. Merrill Lynch took top underwriting honors both in domestic and worldwide issuance. Extensive rankings by type of issues, including international.	Investment Dealers' Digest, April 10, 1989
1989 International Investor's Directory	Extensive information on the world of international investment including corporate addresses, telephone numbers, and officers. Ten major sections includes: international securities firms, investment managers, ADR listings, international stock and international databases.	Asset International, Inc. 18 Desbrosses Street New York, NY 10013

Item	Description	Source
"Trends in Banking Structure since Mid-1970s"	Article describes the major structural changes that have occurred in banking over the past decade at the national, regional, state and local level. During the period, the number of banking organizations has increased sharply. Banks have expanded beyond their traditional geographic borders, differences between commercial banks and nonbank financial institutions have diminished; and the number of bank mergers and acquisitions has soared. Concludes: the factors responsible for these developments are still at work and will likely lead to continued rapid change in banking structure.	Federal Reserve Bulletin March 1989
"A National Lottery Is Not Such A Long Shot"	This year, 28 states and the District of Columbia are running lotteries, which have been the fastest growing source of state revenues in the 1980s. With a deadlock over how to cut the federal budget deficit and no one wanting to be first to mention tax, lotteries alone pass the White House "duck" test. Interesting musings on a federal lottery.	Business Week April 10, 1989
"Rewards of Risk"	On average, mutual funds ended the first quarter up 4.30%, lagging the major market indexes. Stock funds far outpaced bond funds, rising 6.15% for the quarter, versus fixed-income funds' paltry 1.17% return. However, the first quarter's results look positively electrifying compared to the last quarter of 1988. Quick review of of mutual funds first-quarter performance.	Barron's April 10, 1989
"Wary of Junk Bonds"	In spite of the growing respectability of junk bonds, the current size and liquidity of their market and the returns they have generated, pension funds are still cool toward high-yield bonds for fiduciary assets. Results of II poll of pension funds involvement in junk bond markets.	Institutional Investor April, 1989

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SIA
SECURITIES INDUSTRY ASSOCIATION

TRENDS

An Analysis of Emerging Trends in the Securities Industry

Produced by the SIA Research Department

Vol XV, No V August 4, 1989

The Need for Savings and Investment Tax Incentives in the U.S.

Highlights

1. A decline in the personal savings rate in the U.S., coupled with large government deficits in the 1980s, jeopardizes the nation's standard of living and slows economic growth.

2. The meager savings rate is more disturbing given the double-digit savings and investment rates of our international competitors. This puts U.S. companies at a disadvantage in the global marketplace.

3. The U.S. lags behind its major trading partners in capital formation, attributed partly to the higher cost of capital -- a direct result of the lack of savings and investment and higher taxes on these activities. The U.S. cost of capital is almost twice that of Japan and West Germany.

4. The U.S. no longer has the largest stock market in the world. The 67% increase in the capitalization of the NYSE from 1980 to 1988 was outpaced by a 160% gain in several other markets, with the Tokyo Stock Exchange now the largest equity market.

5. Reducing the federal deficit is the most effective solution to the nation's dismal savings rate. Given the growth in government spending in the 1970s-80s, policymakers must first rein in spending before raising taxes.

6. The tax code offers a starting point for getting personal savings and investment on track. The 1986 tax act removed most targeted tax incentives for individuals and put the return from savings and investment -- capital gains, dividends, interest -- on an equal tax footing with other income sources. Given the concern about savings and investment, tax neutrality between income sources is less important than providing incentives to save and invest.

Note: This issue is based, in part, on SIA's testimony on the need to increase savings and investment to the House Ways and Means Committee on April 19, 1989.

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Role of Savings and Investment In the Economy

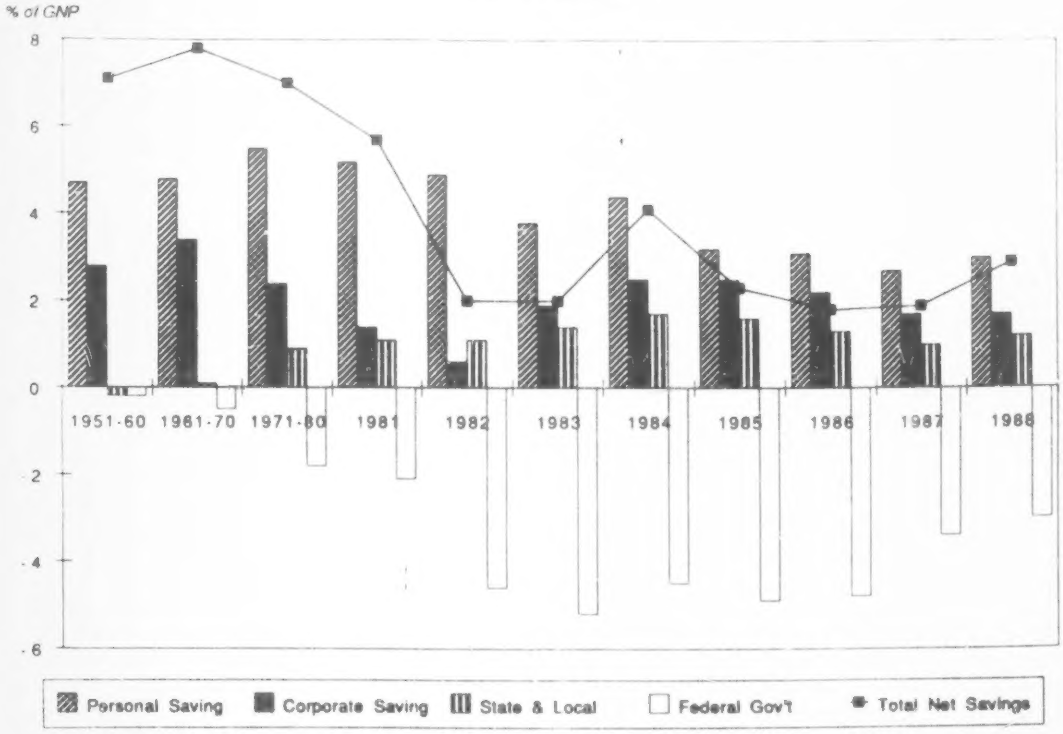
The personal savings rate in the U.S. has slid to the lowest level in about 40 years, a paltry 3.2% in 1987. While the savings rate inched up in 1988 and spurted in the first quarter of 1989 to over 5%, the 1988 gain was relatively anemic and the first-quarter jump, more an aberration than a revival of the savings ethic. However, the second quarter preliminary savings rate continued at over 5%, a hopeful sign. Overall, personal savings in the 1980s has been considerably below past experience, which is cause enough for concern. Savings fuel investment, which provides the capital necessary for economic expansion and ultimately increases the standard of living. Because our major competitors have double-digit saving rates, the meager U.S. savings rate is a formula for reducing U.S. economic competitiveness in an increasingly global marketplace.

By comparison, in the 1980-87 period, the Japanese had a personal savings rate averaging 16.8% and the West Germans, 12.3%. As a result, the ratio of gross fixed investment to GNP averaged over 20% in Japan and West Germany in this period, while it averaged about 15.5% in the U.S.

As a percent of GNP and a component of total national savings, the personal savings rate averaged around 5% in the 1951-80 period (See Chart I). Starting in 1981, personal savings began a decline which brought it to considerably lower levels through 1988. Simultaneously, as personal savings was waning, the federal deficit roared higher. As a percent of GNP, the deficit averaged 1.8% in the 1971-80 period. Over the 1981-88 period, government dissavings peaked at 5.2% of GNP in 1983 and remained more than 4% in the next three years. Hence, total net national savings dropped sharply below the over 7.0% average of earlier decades.

Chart I

U.S. NET SAVINGS



The drop in national savings is traceable to both the federal deficit and a decline in personal savings. However, wherever the blame, the combined effect poses serious threats to the economic health of the U.S. Productivity gains are made possible through investment in new technology, research, new plant and equipment. Michael Boskin, Chairman of the Council of Economic Advisers, has observed: the rate of investment itself can influence the rate of technological change in a society.

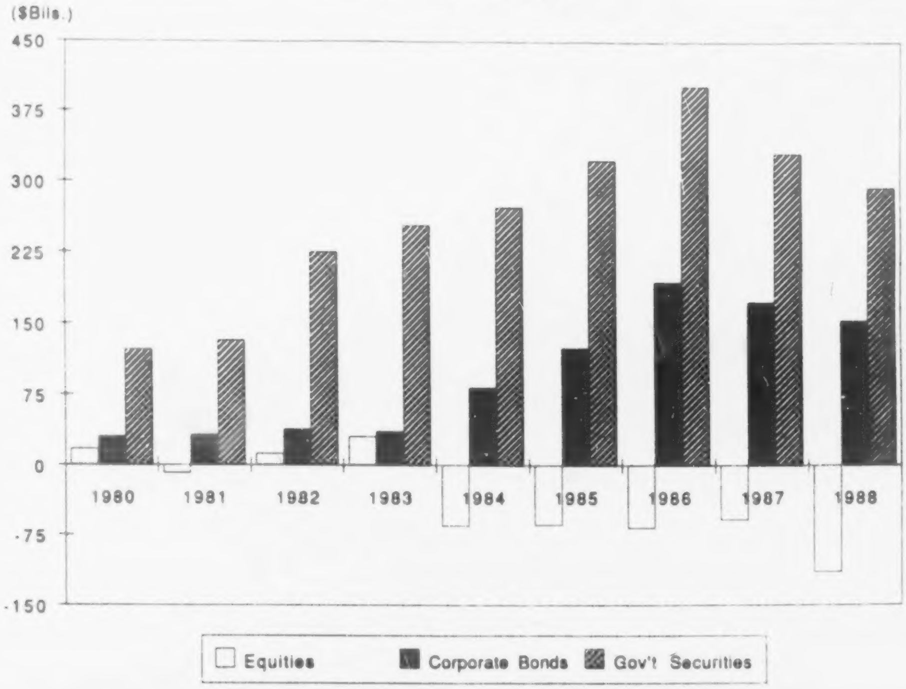
Without the national savings necessary to fund investment, the U.S. has become an importer of foreign capital. Foreign capital accounted for the difference between savings of 3% of GNP in the current decade and investment of about 4.8%. The U.S. has, in effect, borrowed the savings of other countries. While the U.S. economy benefits from such borrowing, there is a price -- the transfer of U.S. wealth to other nations.

While national savings has been sinking, record mounds of debt have been built by the government and private sectors. Targeted tax savings incentives, while they existed, have always been overshadowed by tax policies that fostered consumption. For example, in efforts to dampen consumer spending through borrowing, the 1986 tax act phased out the tax deductibility of personal interest expenses. Recently, the House Ways and Means Committee agreed to accelerate the phase-out by one year. Housing, however, is undoubtedly the largest area where government provides powerful tax incentives to consume -- the mortgage interest deduction and the deduction for property taxes (not to mention the proliferation in home equity loans). This is not the case in many other countries, where housing costs average an even larger percentage of disposable income without government subsidies.

Domestic government debt has ballooned from about $1 trillion in 1980 to about $2.7 trillion as a result of a string of annual budget deficits. Recently, Treasury requested that the public debt limit be raised to $3.1 trillion to avoid an

Chart II

Net Issuance 1980s



August default. U.S. foreign debt is around $500 billion, compared to a positive balance of about $150 billion in 1980. At the same time, the debt of U.S. non-financial companies grew dramatically, while equity capital has dwindled by almost $500 billion in just the last five years (See Chart II).

Whither the savings ethic?

Personal savings is a crucial component of the investment process, as well as the pool from which individuals fund future needs. Traditionally, individuals saved for retirement and old age. Sharp increases in social security benefits and other pension benefits, and the expansion of medicare have eased worries about economic need in old age. Moreover, most of the best academic research suggests the decline in private savings may be permanent since it reflects an enormous expansion in the wealth of older age groups.[1] The younger generation may perceive the relative financial comfort of the older generation as lessening the need for retirement savings.

Demographic trends and increasing life expectancy indicate individuals will need significant savings to enjoy their retirement. Today, at age 65, the average life expectancy is 25% more than it was in the 1930s. By 2025, the over-65 population will double. Moreover, individuals expect far more comfort in their retirement years than ever before.

Many other reasons have been cited for low personal savings -- greater company-provided health and retirement benefits, easier credit availability, and widespread life insurance coverage. So too, the rapid rise in the value of housing since the mid-1970s and the bull market of the 1980s have contributed to a general illusion of wealth. Ironically, the "Golden Goose" is being killed: The improvement in the standard of living Americans now enjoy was wrought, partly by past savings. That improvement is diminishing the propensity to save.

Little mention in discussions of the low U.S. savings rate has gone to the escalating costs of higher and post-graduate education. In a recent article, it was noted that the income gap between high school and college graduates will increase.[2] Although the percentage of high school graduates going on to college has been stable since the early 1970s, that is a larger percentage than for preceding generations.

With the rising cost of tuition and room and board, most families probably finance such outlays out of past savings or by borrowing as the student goes through school. Few families are in a position to cut back consumption on other things by a factor large enough to offset the substantially higher costs for college and post-graduate work. We believe this trend may help to explain the declining savings rate over the last 20 years or so. From 1970-86, tuition costs at private schools increased more than 10% annually on a compounded basis, compared to an increase of under 6% for all consumption items.

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[1] "The Savings Slump: No Easy Solution", Wall Street Journal, 12/19/88.

[2] "What's really squeezing the middle class?", Wall Street Journal, 7/26/89.

The U.S. appears to spend more on education than other nations. This is reflected, to some extent, in the higher average years of formal education in the U.S. versus other nations. For example, although dated somewhat, Table I compares the average level of education in the U.S. to that of 12 other countries. Detail for the table shows that the U.S. ranked second only to Germany in the percent of the population that completed secondary education, while ranking first, by far, in higher education.[3] We believe that trends over time in escalating costs for higher education and the need for such education may explain some of the decline in the U.S. savings rate. In part, the costs of education may be draining U.S. savings compared to other nations, where higher education costs are less or where college is completed by a smaller percentage of the population.

Whatever the reason for the loss of personal savings discipline, an increase in the savings rate is key to a higher rate of economic growth and a faster rise in the standard of living. A high rate of consumption can be financed for a time -- but not forever. When we look beyond short-term cyclical fluctuations to consider experience over the long term, the evidence is overwhelming that countries with high rates of savings and investment are the ones in which productivity, income and standards of living rise most rapidly.[4]

Table 1

Average Years of Secondary and Higher Educational Experience Of the Population Aged 25-64 in 1976

	Secondary	Higher
U.S.	4.75	1.05
12 other countries	3.47	.445
U.S. as % of other 12	137	236

International Comparison of Economic Measures

Sociological and institutional differences taint direct comparisons of savings rates among countries. For example, incentives for private housing in the U.S. reduce the need for a high level of savings for homeownership. Canada does not allow mortgage interest deductions and some other countries provide little, if any, incentives for private homeownership. Indeed, the typical U.S. housing unit is much larger than that available in other nations.

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[3] "Is the U.S. A Spendthrift Nation?", Robert E. Lipsey and Irving B. Kravis, NBER Working Paper Series, National Bureau of Economic Research

[4] "A National Savings President," Martin Feldstein, Wall Street Journal, 11/21/88.

When comparing the U.S. savings rate to that of Japan, other factors should be considered, such as the high cost of housing, limited access to credit, and the demographic trends of the Japanese population. One study found the low ratio of older to working-age individuals explained 90% of the gap between Japanese and U.S. savings. Nevertheless, "...after adjustments of every conceivable kind, what stands out in cross-sectional surveys is the low level of the U.S. savings rate and the high level of the Japanese savings rate."[5]

Direct comparisons can be misleading, but trends in savings and investment offer a reasonable comparison. When comparing the U.S. savings rate to those of other countries, the picture that emerges is disturbing. The savings rates of other countries have also been declining, albeit to a much lesser extent than that of the U.S. For example, the U.S. savings rate in 1987 was 2.5 times lower than the average U.S. savings rate in the 1970s. However, the Japanese and West German savings rates declined by a factor of only 1.2 and 1.1 times, respectively. Nevertheless, of the five major countries compared with the U.S., four had savings rates exceeding the U.S. rate by a minimum of 3 times (See Table II). Until recently, the low U.S. savings fortunately has been bolstered by foreign capital inflows, thus sustaining investment. But, there is no guarantee these inflows will continue and the need to retain such inflows restrains monetary policy to some extent.

In terms of gross fixed capital formation to GNP, the U.S. also has lagged behind its major trading partners. While a comparison of 1972 to 1987 indicates the U.S. has seemingly declined the least, the U.S. ratio is still well below that of the other countries (See Chart III). The divergence in trends in capital formation cannot be easily explained but, the cost of capital is an integral part of any explanation. Lower national savings leads to reduced investment because, by its scarcity, the cost of capital is raised. Even before the Tax Reform Act of 1986, the cost of capital in the U.S. was higher than in several of our major foreign competitors. A 1983 study by the International Trade Commission estimated the cost of capital for U.S. companies was about 16.6%, compared to about 9% for Japanese and West German companies. Higher taxes on capital and investment contribute to differences in the cost of capital between the U.S. and some foreign countries. This differential puts U.S. firms at a competitive disadvantage. Increased savings and lower capital costs would improve the ability of U.S. firms to attract equity capital and to compete successfully on the international level.

Table II

Ratio of Foreign
to U.S. Savings Rate
(Households)

Country	Foreign U.S.
Japan	5.1X
W. Germany	3.8
France	3.7
Canada	2.9
U.K.	1.6

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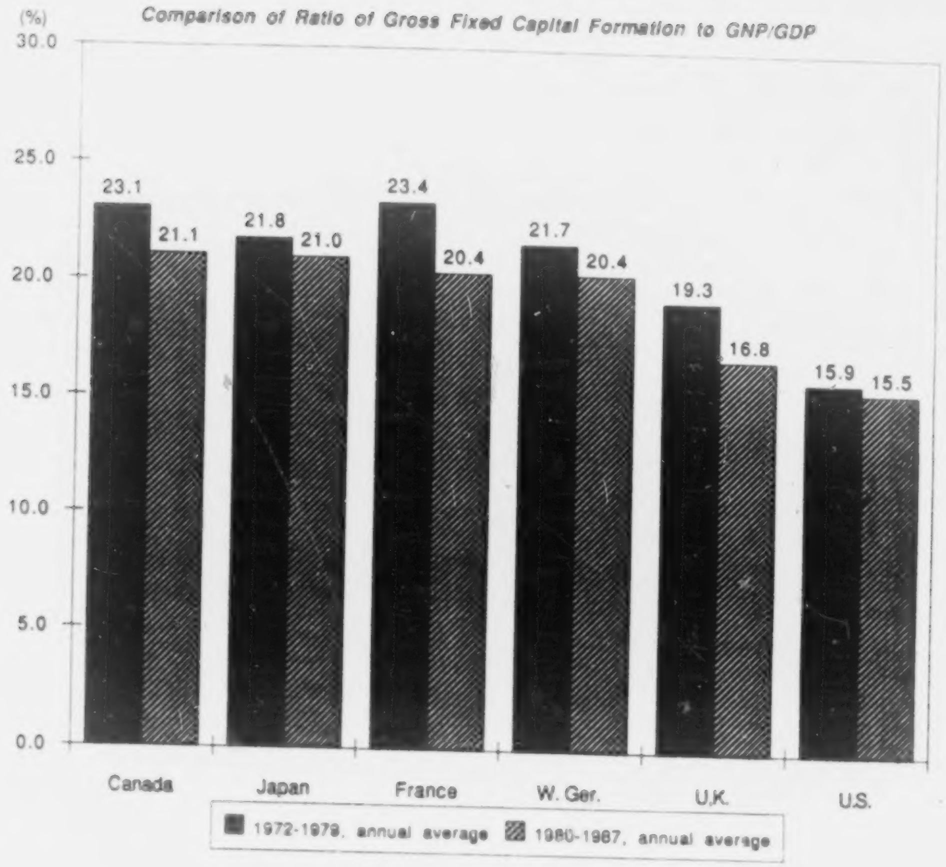
[5] "Saving Rates in Japan and the United States: The Roles of Tax Policy and Other Factors," John H. Makin, 1985.

Chart III

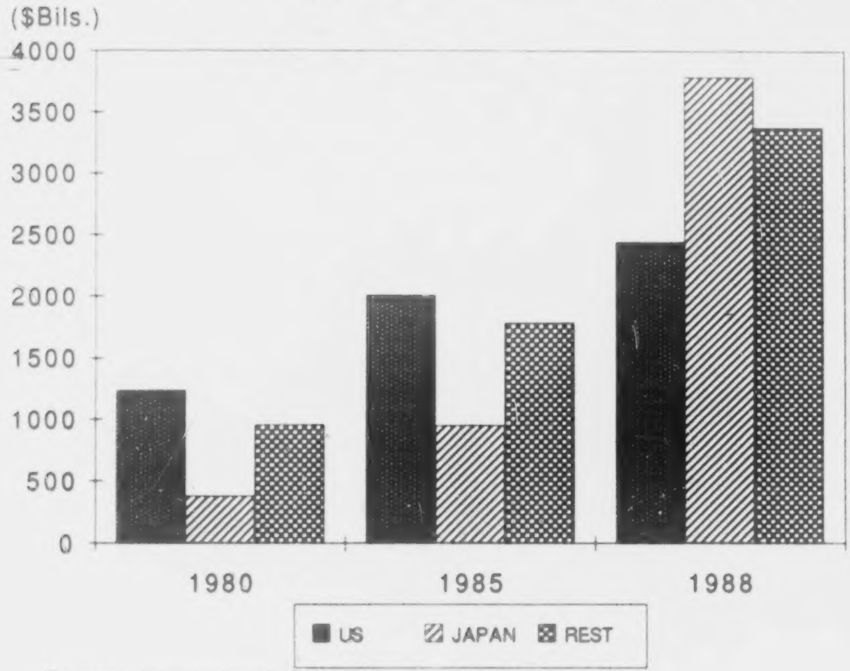


Savings and investment also affect trade balances. Japan had a trade deficit as recently as 1981, and Germany ran a deficit in 1982. Until very recently, both countries have enjoyed increasingly hefty surpluses. The U.S., in contrast, has been in exactly the reverse position. The U.S. maintained a trade surplus until 1982. Since then, deficits have been an increasingly larger percentage of GNP. We believe that the differences in savings and investment in these countries account to some extent for the turnabout in the trade positions of these countries. West Germany and Japan are now in strong competitive positions, while the U.S. trade position is precarious.

Another indicator of the gain our foreign competitors have made in recent years can be measured by equity market capitalization. The premier position of the U.S. equity markets has been lost. The U.S. held 50% of the total market capitalization of all exchanges in 1980 and still claimed a 49% share of world stock markets at year-end 1985. However, by year-end 1988, the U.S. share of world equity markets plummeted to only 30%. Moreover, the Tokyo Stock Exchange has surpassed the New York Stock Exchange as the world's largest market. The 67% increase in the size of the U.S. market from $1.2 trillion in 1980 to about $2 trillion by year-end 1988 was outpaced by the 160% gain in several foreign markets (See Chart IV). While changes in exchange rates, particularly the appreciation of the yen vis-a-vis the dollar have played a role, the U.S. no longer has a monopoly in terms of attracting institutional and individual investors to the equity marketplace with the largest and most diversified companies.

Chart IV

The Increasing Size of Non-U.S. Equity Markets



Source: International Federation of Stock Exchanges

Improving U.S. Savings

The federal deficit is the major drain on the savings generated by other sectors. Reducing the deficit is the most potent solution for our national savings problem. Policymakers wrestle annually with this goal and the hard choices -- spending restraint or tax increases -- that deficit reduction entails. However, looking at the increase of government receipts and outlays relative to GNP growth provides interesting insights. From 1970, government tax receipts have more than kept pace with nominal GNP growth, with the fastest growing component social security taxes due to increases in rates and taxable bases. But, government spending has raced along even faster, outpacing both GNP and revenue growth. Past trends strongly suggest policymakers seriously look to spending restraint before considering tax increases.

Beyond deficit reduction, improving personal savings can help arrest the slide in the national savings rate. Foreign countries provide a more favorable tax treatment of investment income than the U.S., and this has helped to foster higher levels of savings and investment. It is ironic that while the U.S. can claim among the lowest rates on wage and salary income, it can also claim among the highest rates on investment income. Across-the-board, the U.S. falls behind its major competitors in the tax treatment of the return from savings -- dividends, interest, and capital gains. In almost all other countries, targeted tax incentives are used to stimulate savings and investment.

Hence, the tax code offers a starting point for getting savings and investment back on track. In an ideal system for encouraging savings, income saved would be tax exempt and one-step removed from the ideal, the return on savings would be tax exempt. Barring the ideal, improving the after-tax return on savings through targeted tax incentives is one way to influence the savings decisions of individuals and corporate investors.

The trend in the 1980s, however, has been to eliminate targeted savings and investment tax incentives -- IRAs for most individuals, the dividend exclusion and the capital gains exclusion. The Tax Reform Act of 1986 eliminated all targeted incentives for individual equity investment. All savings and investment income is on equal tax footing with other income sources. Indeed, it is becoming clear the returns on equity investment are severely penalized by the double taxation of dividends.

The decline in personal savings should not be taken as evidence that IRAs and the capital gains exclusion, when in existence, did not have an impact on savings decisions. Many other factors may have lowered the savings rate, obscuring the positive effect of savings tax incentives. We suspect that without these incentives, the savings rate would have been lower.

The tax treatment of investment income and the IRA experience merit review and reconsideration. More specifically, policymakers should consider: 1. a permanent and meaningful reduction in the capital gains tax, 2. a method for alleviating the double tax on dividend income, and 3. a special savings allowance that encourages all individuals to save via various savings and investment instruments.

The "preferential" treatment of capital gains, which had existed for 65 years, was eliminated in 1986. The capital gains exclusion existed to acknowledge that many gains reflect nominal, not real gains; that capital loss offsets are limited to $3,000 against ordinary income; and that individuals need incentives to encourage risk taking. With the elimination of the capital gains exclusion, we have seen a continuation in the shrinkage of equity issues in the marketplace and the literal disappearance of initial public offerings (IPOs) despite a 20% increase in stock prices since the beginning of the year.

Many Ways and Means Committee members now recognize the adverse impact of eliminating any tax preference for capital gains. Policymakers are in the midst of a political struggle based on the mistaken notion that only the rich benefit from lower capital gains treatment. Many individuals realize capital gains -- homeowners, those owning their own businesses, taxi medallion owners, etc. Capital gains treatement is not a political issue, it is an economic one.

The double taxation of dividends is widely perceived as inappropriate tax policy. There has been a major restructuring of corporations in the United States, so that corporate capital structures are increasingly resembling that of other nations. The restructuring recognizes the higher cost of equity capital, given no attempt to alleviate the double taxation of dividend income and the elimination of the preferential treatment of capital gains. Most foreign competitors have some form of integration between the individual and corporate tax structures that reduces the double tax impact on dividend income. Although policymakers have been suggesting various limits on interest deductibility, the real focus should be on limiting the tax burden on dividends, thus making equity capital feasible once again and companies less vulnerable to any future business slowdown or recession.

A broad scale tax incentive like the IRA account was highly efficient in the mid-1980s. Unfortunately, a misconception about these programs was that savings was diverted from other savings programs. Recently, there has been growing evidence that IRA programs did indeed increase incentives to save and that individuals strongly preferred to save if it meant being able to reduce their taxes substantially.

Capital Gains Treatment

The 1986 tax act contained the largest increase in capital gains taxes in history; a 65% increase for investors in the top tax bracket and an even greater increase for some middle income investors. The elimination of the exclusion added a heavy weight to the bias against long-term equity investment.

The 1978 and 1981 capital gains tax cuts are a documented success story. Individuals reacted by supplying increased amounts of capital for equity investment, particularly for small companies which create jobs and new technology. Importantly, tax revenues were raised, not lost, for Treasury. But, the significant economic consequences of lower capital gains taxes are worthwhile even if revenues are not raised. (A summary of these consequences are contained in SIA's Statement to the Ways and Means Committee, April 13, 1989.)

Our foreign competitors have recognized the benefits of encouraging investment. Three major foreign countries -- Belgium, Italy and the Netherlands -- do not tax capital gain, and Germany exempts long-term gain (See Table III). Compared with the six countries taxing long-term gains, the U.S. treatment of capital gains is among the harshest. Canada, France and Sweden tax long-term capital gains at rates ranging from 16% to under 20%. While Australia and the U.K. have higher statutory long-term capital gains tax rates than the U.S., substantial exemptions and indexing of the cost basis result in more favorable capital gains tax treatment than in the U.S. Effective in April, Japanese investors have a choice of a 1% tax on gross proceeds or a 20% net capital gains tax. Previously, capital gains were exempt in Japan.

Dividend Income

In recent months, much attention has focused on the leveraged buyout phenomena and the subsequent build-up of corporate debt. Although various measures of debt are used, corporate debt as a percent of current GNP is about 37% compared with 30%-35% during the 1967-85 period. Meanwhile, in 1984-88, about $500 billion of equity was removed from the market and estimates place 1989 equity retirement as high as $166 billion.[6] Policymakers, for the most part, look to "penalize" LBO activity rather than encouraging equity investment. The anti-savings slant, or debt bias, in the tax code is most apparent in the disparate treatment of corporate debt and equity. There are legitimate financing roles to be played by both debt and equity, but there is no logical reason for the tax code to favor one over the other.

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[6] "Rapid Stock Supply Shrinkage Continues", Wall Street Journal, 7/14/89.

Table III

Summary of Individual Taxation of Capital Gains on Portfolio Stock Investment

Countries	Maximum Short-Term Cap. Gain Tax Rate	Maximum Long-Term Cap. Gain Tax Rate	Period to Determine Short- Or Long-Term Gain	Maximum Annual Net Worth Tax Rate
United States	33%	33%	One Year	None
Australia(A)	50.25%	50.25%	One Year	None
Belgium	Exempt	Exempt	None	None
Canada(B)	19.33%	19.33%	None	None
France(C)	16%	16%	None	1.1%
Germany(D)	56%	Exempt	Six Months	.5%
Italy	Exempt	Exempt	None	None
Japan(E)	20%	20%	None	None
Netherlands	Exempt	Exempt	None	.8%
Sweden(F)	42%	16.8%	Two Years	3%
United Kingdom(G)	40%	40%	None	None
Hong Kong	Exempt	Exempt	None	None
Indonesia(I)	35%	35%	One Year	None
Malaysia	Exempt	Exempt	None	None
Singapore	Exempt	Exempt	None	None
South Korea	Exempt	Exempt	None	None
Taiwan(J)	Exempt	Exempt	One Year	None

Note: This is a summary of the preliminary results of a study by SIA/Spicer Oppenheim to be completed in August. Details will be provided on special situations affecting the taxation of capital gains in the final study. Conversion of exchange rates as of 4/7/89. State, local and provincial taxes not included.

(A) Long-term capital gains from assets acquired prior to 9/20/85 is tax exempt and cost basis of other assets held more than 1 year is indexed for inflation.
(B) Lifetime cumulative capital gain exemption of $83,857 (Canadian $100,000); $419,287 (Canadian $500,000) for gain on sale of shares in small business.
(C) Exemption for capital gains on sale proceeds of up to $45,518 (FF 288,400).
(D) First $533 (DM 1,000) of short-term gain is exempt annually.
(E) Effective 4/1/89, capital gains tax on sale of stocks or securities. Previously, gain was exempt.
(F) A 60% exclusion for long-term gain produces lower long-term rate.
(G) First $8,480 (5,000 pounds) of gain is exempt annually.
(I) For securities held more than 1 year, gain is taxed at an average effective rate which varies depending on several factors, but is generally lower than 35%.
(J) During 1989, the following are tax exempt: (1) all gain from the sale of stock acquired before 1989 (2) up to $366,300 (NT $10,000,000) of gain on stock acquired after 1988, and (3) 50% of the gain on unlisted securities held for more than one year. If these exemptions do not apply, the individual is subject to national income tax at a maximum rate of up to 50%.

The full deductibility of corporate interest payments and the double tax on corporate dividend payments have been a long-standing feature of the tax code. However, many point to the 1986 tax act as stimulating the trend toward debt financing that began in the mid-1980s. Under the old law, corporations could enhance the returns of taxable investors by retaining and converting earnings into capital gains, which were taxed at a lower individual rate than dividends or interest. The 1986 tax act eliminated this distinction. In addition, while the incentive to retain earnings from the viewpoint of the shareholder was eliminated, the 1986 act also made it more advantageous for a corporation to disburse income (capital gains or other income sources) because individual rates were now lower than corporate tax rates.

Table IV

Summary of Individual Taxation of Dividend Income

Countries	Corporate/ Shareholder Integration	Maximum Marginal Tax Rates	Special Allowances Or Exemptions Other Than Integration
United States	No	33%	None
Australia	Yes	18.4%	None
Belgium	No	25%	None
Canada	Yes	19.6%	None
France	Yes	35.2%	Annual Exemption (A)
Germany	Yes	31.3%	Annual Exemption (B)
Italy	Yes	21.9%	Special Allowance (C)
Japan	Yes	45%	Annual Tax Credit (D)
Netherlands	No	72%	Annual Exemption (E)
Sweden	No	42%	Annual Deduction (F)
United Kingdom	Yes	20%	Special Allowance (G)
Hong Kong	NA	Exempt	NA
Indonesia	No	35%	None
Malaysia	Yes	15.4%	None
Singapore	Yes	0%	None
South Korea	Yes	25%	Special Allowances (H)
Taiwan	No	50%	Annual Exemption (I)

Note: This is a summary of the preliminary results of a study by SIA/Spicer Oppenheim to be completed in August. For countries that have integration, the maximum effective rate is shown. Details will be provided on methods of integration and special situations affecting the taxation of dividend income in the final study. Conversion of exchange rates as of 4/10/89. State, local and provincial taxes not included. NA - Not applicable.

(A) Annual dividend (or interest) exemption of $2,526/$1,263 (FF 16,000/FF 8,000) for married single taxpayers.
(B) Annual dividend (or interest) exemption of $321/$160 (DM 600/DM 300) for married/single taxpayers.
(C) Special savings stock similar to preferred but without liquidation preferences taxed at 15% rate at the source.
(D) Annual tax credit of 10% of dividend income up to $75,700 (Yen 10 million) and 5% for the excess over that amount.
(E) Annual exemption of $947/$473 (DFL 2000/DFL 1,000) for married/single taxpayers. Special $473 (DFL 1,000) exemption for dividends for recognized venture capital company.
(F) Annual deduction of $257 (SEK 1,600) per person.
(G) Tax exemption for dividends on personal equity plans.
(H) A 10% maximum tax applies to dividends on (1) stock exchange listed shares, (2) certain agricultural, fishing and livestock companies and (3) employee shareholders of non-listed stock.
(I) Annual exemption of $13,338 (NTD 360,000) for listed companies dividends.

Most foreign countries have some form of integration of corporate and individual taxes to mitigate the double tax on the current return on equity investment. Of ten major industrialized countries, seven have a form of integration (See Table IV). Moreover, of these seven countries, five -- France, West Germany, Italy, Japan and the U.K. -- also have special allowances and exemptions to encourage equity investment.

Interest Income

Similarly, four of ten major foreign countries generally apply tax rates lower than in the U.S. on interest income (See Table V). Of note, Japan has the lowest rate, 15%, on the investments reviewed. In addition, while some countries have rates higher than the U.S. and some have exempted instruments equivalent to municipal obligations, other savings incentives are also provided. For example, interest on 5-year savings accounts of a maximum of $11,759 is tax exempt in Sweden.

Table V

Summary of Individual Taxation of Interest Income

Countries	National Government Bonds	Corp. Bonds	Savings Accounts	Other Interest	Special Allowances Or Exemptions
United States	33%	33%	33%	33%	Exemption (A)
Australia	50.25%	50.25%	50.25%	50.25%	None
Belgium	25%	25%	25%	25%	None
Canada	29%	29%	29%	29%	None
France	56.8%	56.8%	56.8%	56.8%	Exemption (B)
Germany	56%	56%	56%	56%	Exemption (C)
Italy	12.5%	12.5%	30%	50%	Exemption (D)
Japan	15%	15%	15%	15%	Exemption (E)
Netherlands	72%	72%	72%	72%	Exemption (F)
Sweden	42%	42%	42%	42%	Exemption (G)
United Kingdom	40%	40%	20%	40%	Exemption (H)
Hong Kong	Exempt	Exempt	Exempt	Exempt	None
Indonesia	35%	35%	15%	35%	None
Malaysia	Exempt	45%	5%	40%	Exemption (I)
Singapore	Exempt	Exempt	Exempt	Exempt	None
South Korea	10%	10%	10%	25%	None
Taiwan	50%	50%	50%	50%	Deduction (J)

Note: This is a summary of the preliminary results of a study by SIA/Spicer Oppenheim to be completed in August. Details will be provided on special situations affecting the taxation of interest income in the final study. Conversion of exchange rates as of 4/10/89. State, local and provincial taxes not included.

(A) Interest from state and local obligations is tax exempt.

(B) Interest on certain savings accounts is tax exempt. Elected withholding at the source results in 27%, and 47% rate on savings account. Annual rate on bonds interest (or dividend) exemption.

(C) Interest on certain long-term government bonds exempt.

(D) Certain bonds are tax exempt or taxed at lower rates.

(E) Interest on certain employee savings accounts exempt.

(F) Annual exemption of $944/$472 (DFL 2,000/DFL 1,000) for married/single taxpayers.

(G) Certain savings accounts for a 5-year term are exempt. The maximum account is $11,759 (SEK 75,000).

(H) Interest on National Savings Certificates is exempt.

(I) Interest on savings accounts of up to $1,832 (M $5,000) is exempt. Interest on fixed deposits held for at least 12 months with the National Bank is tax exempt.

(J) Special deduction of up to $13,153 (NTD 360,000) can be offset against interest (or dividends) from certain types of savings and investment.

IRAs/401(k) Plans

Similar to preferential treatment of capital gains, Individual Retirement Accounts(IRAs) are an example of a targeted tax incentive of the 1980s that was tried, worked and then weakened. With the liberalization of IRA requirements in 1982, these accounts were claimed on 12 million tax returns, bringing about $28.3

billion in savings. By 1986, over 15 million returns showed IRA contributions of over $37 billion. The 1986 tax act curtailed the tax deductibility of IRA investment for most individuals. In 1987, with the limited availability of the IRA tax deduction, only 7.4 million returns claimed IRAs and the amount of funds saved in these accounts plunged 62% to only $14.1 billion (See Table VI). The tax deductibility of IRA contributions proved a powerful incentive for generating significant savings -- a fact that is now being confirmed by considerable research.

While the statistics show that individuals did indeed respond to the IRA tax incentive, much controversy has surrounded the origin of IRA funds -- new savings or the shift of other assets. Included in the IRA literature is a series of studies by Steven F. Venti and David A. Wise for the National Bureau of Economic Research. Three of their main conclusions are: 1. IRAs had a substantial positive net effect on personal savings; 2. Two-thirds of the families contributing to IRAs had annual incomes of less than $50,000; and 3. IRAs did not merely substitute for other forms of retirement savings.

Table VI

Individual Retirement Arrangements
Adjustments to Income
($ Billions)

Year	Number of Returns	Amount
1980	2,564,421	$3.4
1981	3,415,053	4.8
1982	12,010,038	28.3
1983	13,613,167	32.1
1984	15,232,856	35.4
1985	16,205,846	38.2
1986	15,535,531	37.8
1987P	7,351,364	14.1

Source: Statistics of Income Bulletins

Hence, actual data and a growing pool of academic research combine to present a strong case for IRAs as a savings incentive. In addition, an often unrecognized benefit of IRA-type incentives is psychological. Through the very advertising that firms engage in to attract IRA accounts, individuals may focus more on the need to save.[7] For tax year 1984, about one-half of IRA contributions were made in 1985. This "last minute" response suggests that the stepped-up IRA advertising also stepped-up individuals' awareness of this savings incentive and sensitivity to tax policy.

Section 401(k) plans have had explosive growth during the past decade. The combined assets of these plans exceeded $70 billion by 1986. In that year alone, employees contributed $6.4 billion and employers added $2.4 billion, according to the Employee Benefit Research Institute. Most of these plans offer a combined appeal for saving: a tax incentive from the government, a "matching" payment from the employer, and the ease and convenience of an automatic payroll deduction.

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[7] "The Budget Deficit Problem: 1989" by Lawrence H. Summers, Tax Notes, 3/6/89.

It is too soon to quantify the damping effect the 1986 restrictions on these plans may have had. Some plans have been cancelled, and some funds previously contributed have undoubtedly been diverted from savings. No reliable data measuring these effects has yet been developed.

Special Allowances and Exemptions

Special allowances and exemptions are widely used by many foreign nations to spur individual savings and investment. The following is a small sampling of the special provisions used by other countries in the treatment of savings and investment income.
Capital Gains: Canada has a lifetime exemption of $83,857 and a larger exemption for proceeds from sale of shares of small business. France excludes capital gains on sale proceeds of up to $45,518.

Dividend Income: Most major countries use an integrated system as well as exemptions and deductions for dividend income. The Netherlands has an annual exemption of $947/$473, while the U.K. exempts dividends (and capital gains) from "personal equity plans".

Interest Income: Several countries offer tax exemption for the interest return on certain investments and types of savings deposits held for a specific period of time; i.e., five years in Sweden. In the U.K., the interest return on a National Savings Account is tax free.

Summary

Tax incentives can and have stimulated individual savings and investment. The U.S. cannot afford to wait to encourage savings. An aging population and increasing competitive challenges do not allow room for error in calculating future savings and investment needs. With the tax code now void of any targeted savings incentives, policymakers have an opportunity to implement meaningful measures to improve U.S. savings and investment.

In particular, with concern over the debt build-up by corporations, government and consumers, initiatives to foster equity investment would make a start at alleviating the tax code's debt bias. A reduced capital gains tax and relief from the double tax on equity are relevant options. So too, many individuals responded to the IRA tax incentive for savings.

Policymakers have many hard decisions to make, particularly when faced with trade-offs between additional spending and tax policies. However, policymakers also need to recognize that a dangerous trend has started in the U.S. -- a meager savings rate that has forced the U.S. to rely on the savings of other countries to finance investment. There is nothing wrong with foreign investment per se, except that sooner or later it involves a transfer of resources from the U.S to other nations to pay for borrowed funds. It also puts severe pressure on U.S. monetary policy to keep the dollar strong and interest rates relatively favorable to continue to attract and retain foreign funds in the U.S.

Substantial changes are taking place in the U.S. through corporate restructurings and other developments. The tax code plays a major role in these changes. Corporations and individuals respond to tax incentives as well as tax penalties -- this has been demonstrated many times in the past. If Congress wants to reward risk-taking and equity investment, the tax burdens have to be lifted. Increased taxes on interest will only serve to curb an important source of capital in this country relative to other nations and put U.S. investment at a competitive disadvantage.

Government spending has increased faster than GNP -- a documented trend. Many individuals favor additional government spending because it offers them greater benefits and expectations. However, government spending has to be financed eventually -- witness the recent furor over catastrophic medical insurance for the elderly. Additional spending cannot be financed without greater deficits or higher taxes, neither of which is desirable given the recent trends in these areas. When public programs become unweildy, there is much temptation for fraud and waste -- as with the recent HUD debacle.

Other nations are increasingly learning that the private sector does a much better job than the public sector in allocating resources and providing for an expanded economy. The U.S. should continue to heed its own example and rely on the private sector. Nevertheless, if the U.S. savings rate is to be boosted, targeted tax programs to encourage savings are necessary. Both the capital gains exclusion and IRA programs are two recent examples of very successful incentives that were eliminated. We believe it is time to take some small steps forward and re-enact such measures rather than argue that the 1986 tax act negates such programs.

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VOLUME

	MAY 1989	YTD 1989	MAY 1988	YTD 1988	% CHG YTD 1989-1988
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	170.4	165.8	153.9	170.5	-2.8%
AMEX (MILS.)*	11.5	11.7	8.9	10.3	13.5%
NASDAQ (MILS.)*	140.0	133.4	117.5	125.7	6.1%
REGIONAL EXCHANGE (MILS.)*	27.3	26.5	19.6	23.6	12.2%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$136,380	$611,358	$101,526	$584,339	4.6%
AMEX (MILS.)	3,605	14,692	2,453	13,556	8.4%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	11,489	46,966	6,504	36,830	27.5%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	18,219	84,821	13,597	73,206	15.9%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	52.2%	52.5%	57.3%	53.8%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	11,499	53,341	8,116	44,528	19.8%
AMEX OPTIONS	3,564	16,874	2,789	15,345	10.0%
COMMODITY	24,575	113,787	19,708	96,072	18.4%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

YIELDS

(MONTHLY AVERAGES)

	MAY 1989	MAY 1988	BASIS POINT CHG 1989-1988
BOND BUYER INDEX (20 BOND)	7.25%	7.90%	(65)
CORPORATE BOND YIELDS (MOODY S)			
Aaa CORPORATE	9.57	9.90	(33)
Baa CORPORATE	10.46	11.04	(58)
RATIO Aaa CORPS. TO Baa CORPS.	0.91	0.90	2

PRICES

(END OF MONTH)

	MAY 1989	MAY 1988	% CHG MAY 1989-1988
DOW JONES INDUSTRIALS	2480.15	2031.12	22.11%
STANDARD & POOR S 500	320.52	262.16	22.26%
NYSE COMPOSITE	178.85	148.04	20.81%
AMEX MARKET VALUE INDEX	356.66	294.19	21.23%
VALUE LINE COMPOSITE	263.21	226.42	16.25%
NASDAQ COMPOSITE	446.17	370.34	20.48%

UNDERWRITING

	MAY 1989	MAY 1988	% CHANGE 1989-1988
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$22,971.6	$23,774.6	-3.4%
Common Stock	$1,763.7	$2,844.8	-38.0%
# of Common Stock Issues	46	36	27.8%
Preferred Stock	$587.9	$474.0	24.0%
# of Preferred Stock Issues	9	8	12.5%
Corporate Debt	$20,620.0	$20,455.7	0.8%
# of Corporate Debt Issues	108	135	-20.0%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$5,217.0	$6,243.0	-16.4%
# of Issues	324	403	-19.6%
Competitive	$2,210.0	$2,272.0	-2.7%
# of Issues	304	325	-6.5%

Source: Securities Data Co.

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
Report on Production And Earnings of RRs In 1988	Retail production, payout percentages and earnings... were Down, Down and Down. Overall, the picture was brighter for institutional RRs. Included in this report is detailed information on; gross production levels of retail and institutional RRs; payout percentages; W-2 earnings levels and trends; and branch manager earnings. Data are listed for the industry as a whole and are also presented by firm-size categories.	Securities Industry Association Contact: Pamela I. Faber
1989 Mutual Fund Fact Book	An extensive guide on trends and statistics in the mutual fund industry during 1988. The Fact Book is divided into two main sections - text and data. The "text" section of the book covers basics in the history and development of the industry as well as trends in 1988. The data section involves information on assets, sales and redemptions.	Investment Company Institute 1600 M. Street, N.W., Suite 600 Washington, DC 20036
Save America: A Primer on U.S. Savings and its Effect on Economic Health	This study analyzes the available theory and data on savings. Among the findings were: a 2.5 percentage point increase in the personal savings rate annually could add roughly 10 percentage points to GNP in ten years, IRAs successfully generated new savings, and reducing the tax penalty on savings will result in significant increases to the amount saved. The findings of this study support tax incentives for savers.	Institute for Research on the Economics of Taxation (Sponsored by: Merrill Lynch Capital Markets)
Tax Policy for the 1990s: Challenges and Opportunities	This booklet summarizes the proceedings of a symposium sponsored by Coopers and Lybrand and New York University to explore crucial tax policy issues facing the nation in the coming decade. Participants discussed the current economic environment, fiscal policy solutions to the budget deficit, and tax policy alternatives.	Coopers & Lybrand 1251 Avenue of the Americas New York, NY 10020

Item	Description	Source
Report on New York Tax Provisions Relating To Corporate Mergers And Acquisitions	This report comments on the legislation recently enacted in New York relating to corporate acquisitions, mergers and considerations. The report concludes that the rule suffers from major defects and recommends that the rules be repealed.	New York State Bar Association (Tax Section)
Tax-Credit and Subtraction Methods of Calculating a Value-Added Tax	This report discusses the advantages and disadvantages methods used for calculating a value-added tax whether or not a value-added tax achieves the policy goals established for it could depend, in certain cases, on the method chosen to calculate the tax. Policy considerations, such as offsetting regressivity or keeping the tax from harming exports, may call for exemptions, multiple rates, or eliminating the tax for certain sales. This analysis addresses such issues.	United States General Accounting Office Washington, DC 20548
Deposit Insurance: Lessons From the Record	The deterioration of the federal deposit insurance funds, particularly the FSLIC, has become a common theme in the press and a major concern of financial regulators. This article considers possibilities for deposit insurance reform in the light of historical success and failures of bank liability insurance in the U.S.	Economic Perspectives Federal Reserve Bank of Chicago (May/June 1989)
How Capital Costs Cripple America	The stunted national savings rate raises capital costs and discourages investment effectively prohibiting some investments. This leads to overseas rivals of U.S. manufacturers having a solid advantage. This article explores three key changes in the tax laws which would help to close the gap.	Future Magazine (August 14, 1989)

A8825-1

SIA
SECURITIES INDUSTRY ASSOCIATION

TRENDS

An Analysis of Emerging Trends in the Securities Industry

Produced by the SIA Research Department

Vol. XV, No. 6
October 20, 1989

SECURITIES INDUSTRY FIRST HALF 1989 ANALYSIS

Highlights

1. Securities industry 2Q profits shot up five-fold over 1Q. NYSE member broker-dealers posted $1 billion in pre-tax earnings in 2Q, their best showing since 1Q88. However, over half of these profits were posted by the 10 Large Investment Banks (LIBs).

2. Risk-based revenues in the securities industry -- principal transactions, investment banking, M&A -- now account for 64% of all revenue vs 42% in 1980.

3. The handful of LIBs have used their capital and leverage to follow a risk-based strategy which has given them a market share this year of 50% of all industry assets, one-third of all industry revenues and capital while employing only 14% of the workforce.

4. Direct M&A fees are estimated to be $4.5 billion for full-year 1989, matching last year's total. In 1988, we estimate that the LIBs captured 56% of these fees, National Full Line firms (NFLs) an additional 27%, banks and boutiques 7%, each, with 4% distributed among other NYSE firms.

5. Consolidation continues in the investment banking areas - LIBs handled 40% of 1H89's private placement volume; NFLs managed 28%, money center banks captured a record 30%, with only 1% distributed among other firms. Meanwhile, a record 90% of 1989's corporate bond underwritings were done without syndication.

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INDUSTRY PROFITABILITY

2Q Provides Much Needed Shot In The Arm - But Is It Enough?

The long, post-crash slide of brokerage earnings finally curved up in the second quarter with a five-fold increase in profits. However, 2Q closed on the industry's best month of the year. Since 3Q had no month duplicating June's performance and closed on a very weak September (not to mention 4Q's start with a volatile, uncertain October), the uplift may only be temporary and 3Q profits are expected to be only half those generated in 2Q.

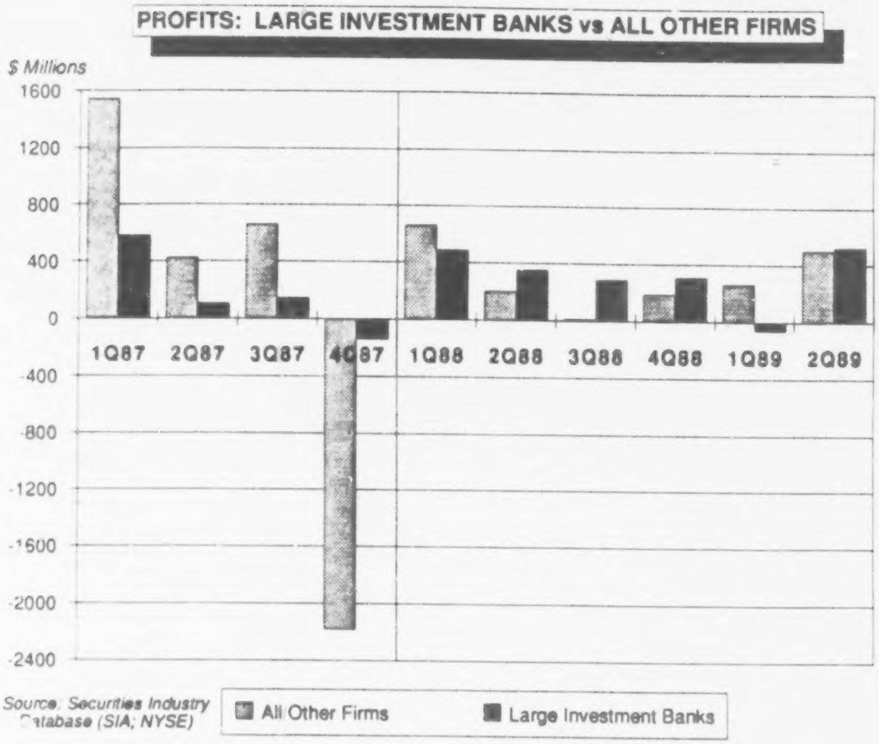
Securities industry[1/] pre-tax profits in 2Q soared to $1 billion - five times 1Q's anemic $200 million level, the post-crash low. By the way, this also equaled the combined profits for the most recent three quarters and virtually tied 1Q88 for the best post-crash quarter. The surge came from a vastly improving revenue picture spawned by increased transaction volume and particularly a falling interest rate environment.

The increase was felt across the spectrum of securities firms but particularly at the Large Investment Banks (LIBs). As **Exhibit 1** shows, the LIBs suffered the least during the crash and accounted for 58% of industry profits last year even though they make up less than 3% of all NYSE member firms.

Hurt by rising rates, with corresponding bond trading losses combined with disappointing investment banking results, the LIBs penned their first red ink since the crash during 1Q89. However, when interest rates headed downward in 2Q, they recovered and again posted profits higher than the rest of the industry combined -- a trend which greatly accelerated after the crash and has become, with time, part of the new structural fabric of the securities industry.

[1/] For purposes of Trends, total "securities industry" figures are those of the domestic broker-dealer units of NYSE member firms doing a public business. While small in number (under 400), during the past few years these firms have accounted for 75-80% of total revenues of all (approx. 9,000) broker-dealers registered with the SEC. Also, these figures do not include non-domestic, non-broker-dealer business conducted within securities firms' umbrella holding companies, a substantial amount for the largest firms (LIBs and NFLs) but insignificant for the balance of the industry.

EXHIBIT 1



PROFITS: LARGE INVESTMENT BANKS vs ALL OTHER FIRMS

Source: Securities Industry Database (SIA; NYSE)

Industry-wide, although the totals are dominated by the LIBs and National Full Line firms (NFLs), commissions climbed 11% in the second quarter to a post-crash high of $2.7 billion. A flattening of the yield curve, which had depressed trading results for over a year while inverted, enlivened both bond trading and profits. Trading profits soared 31% to $3.7 billion in 2Q - the highest level in over two years. Underwriting revenues also shot up 23% in 2Q, but were still mediocre compared to most other quarters, both pre- and post-crash.

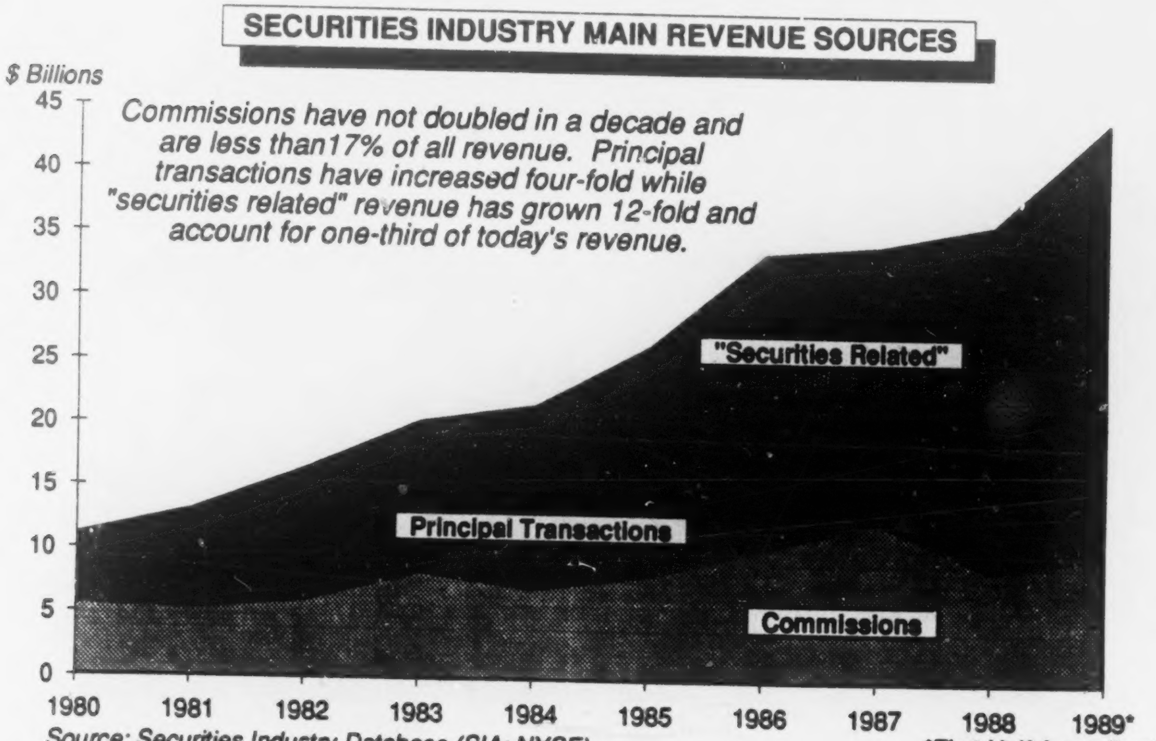
"Other revenue related to the securities business," an anachronistic hodgepodge of investment banking revenues (due to an archaic regulatory reporting schedule), continued its non-stop ascent to record levels. This line, mainly interest income (both gross and net) and M&A-related and private placement fees, climbed 12% to $5.4 billion in 2Q and now accounts for a full one-third of total industry revenues.2/

2/ It is indeed "challenging" to analyze an industry where the most important revenue line is identified as "other revenue related to the securities business" while commissions, which account for less than 17% of revenues, has four separate component breakdowns. In just two years, this "other revenue" line has grown from 23% to 34% in relative importance to all revenues, and for LIBs, it now totals over 57% of their total revenues!

Unbroken by the crash, this line's continued growth, both in aggregate and relative to other revenue sources, reflects the changing nature of Wall Street towards risk-based, principal transaction, investment banking. For some time now, the growing fees earned in the sizable M&A portion of this line have been augmented by profitable cash-outs of firms' equity portions in these deals. But as some of these highly leveraged (and often sizable) transactions now begin to unwind (i.e. Campeau/Allied/FDS), also sizable realized and unrealized losses may begin to eat into, or even reverse, previously booked income. Third quarter results are expected to reflect some of this trend, particularly for the main players, LIBs and some NFLs.

Exhibit 2 puts the industry's three main revenue lines into perspective. The traditional, safe revenue source (and until the mid-Eighties, the single largest), commissions, has remained basically static this decade, starting at $5.6 billion in 1980, peaking at $12.7 billion in 1987, and falling back to $8.8 billion last year and $10 billion this year, annualized. Commissions are becoming less important to the overall industry's income statement -- just 17% of total revenues the past few years. However, for many smaller firms, it is still the dominant revenue source.

EXHIBIT 2


SECURITIES INDUSTRY MAIN REVENUE SOURCES

Commissions have not doubled in a decade and are less than17% of all revenue. Principal transactions have increased four-fold while "securities related" revenue has grown 12-fold and account for one-third of today's revenue.

Source: Securities Industry Database (SIA; NYSE)

**First Half Annualized*

Principal transactions, mainly debt trading, have grown four-fold over the same time frame, from $3.7 billion to a $14 billion pace this year, or about a quarter of all revenues. Even this amount is understated since principal transactions are not reported as gross revenue but as trading and investment gains net of losses.

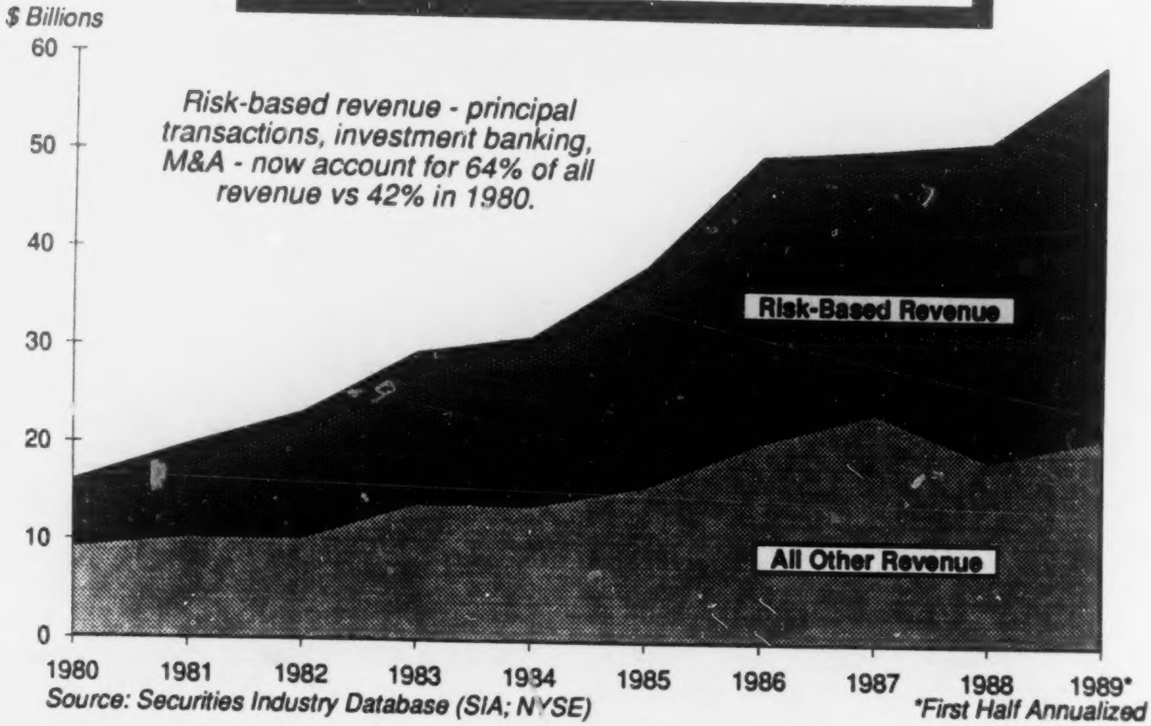
Again, the biggest revenue line today, accounting for one-third of total revenues, is the "other securities related" line, which at a $20+ billion clip this year is 12 times its' 1980 level. With such a large portion of revenues now being reported in this nebulous line, we thought it important to try to analyze the main segments of this revenue growth.

TODAY'S SECURITIES INDUSTRY: A RISK-BASED BUSINESS

Exhibit 3 shows just how much of the securities industry's revenue base has become "risk-based." Included are trading and investment gains (losses), otherwise called "principal transactions," underwriting revenues and the "securities related" revenue line, again, mainly interest, private placement fees, and M&A and merchant banking revenues. A portion of this revenue may be "riskless," such as fees without equity or bridge commitments, and matched repo/reverse repo books. Nevertheless, about two-thirds of the industry's revenue base is now tied to capital at risk!

EXHIBIT 3

SECURITIES INDUSTRY ALTERED REVENUE BASE

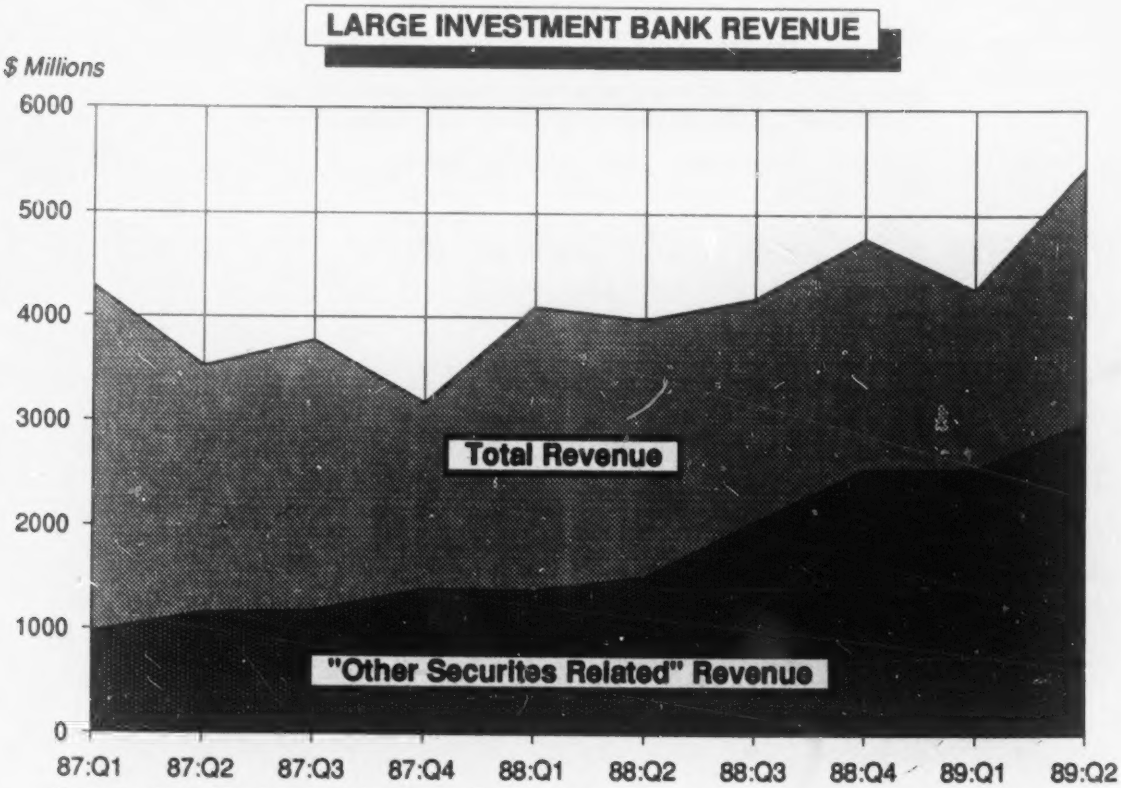


Source: Securities Industry Database (SIA; NYSE)

**First Half Annualized*

With investment banking driving the "other related revenue" line, the LIBs will have a good share of their revenue from this source. **Exhibit 4** shows how rapidly the "securities related" revenue has grown at the LIBs. This line is expected to generate about 57¢ of every $1 of revenue brought in by the LIBs this year compared to 23¢ for the rest of the industry or just 13¢ at Regional firms.

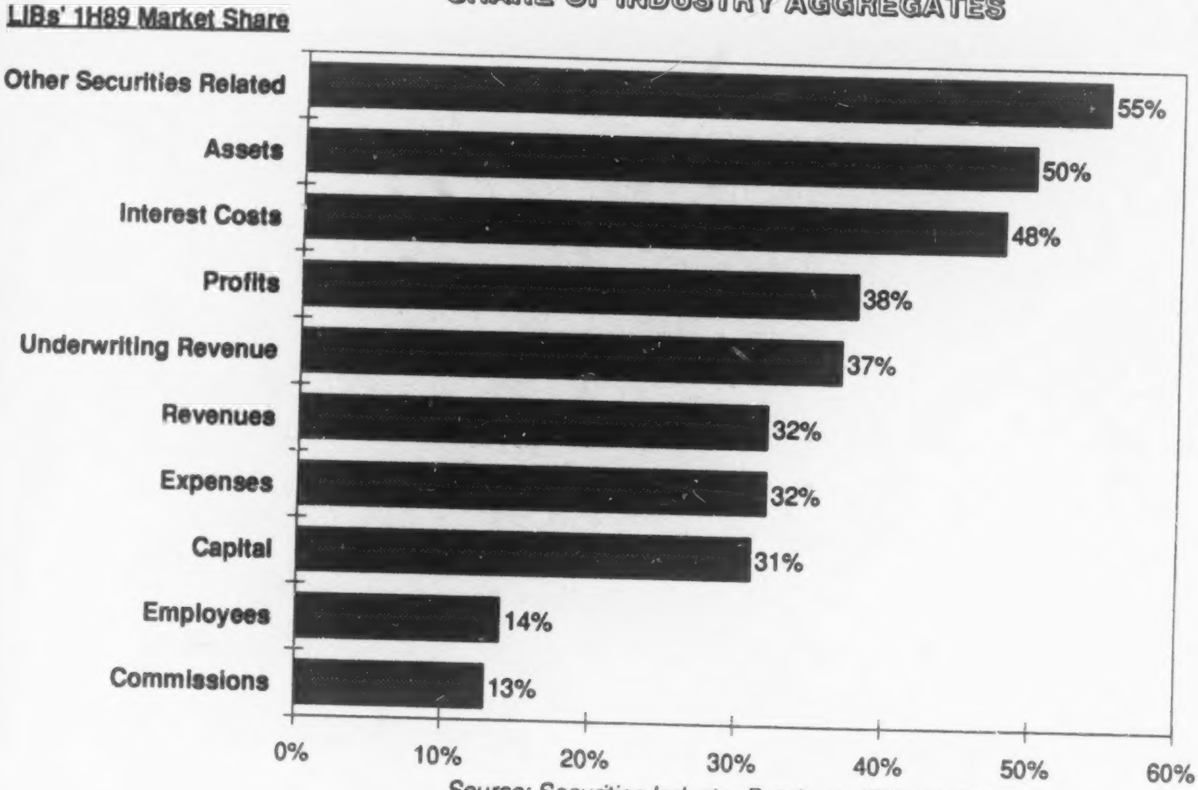
EXHIBIT 4



Source: Securities Industry Database (SIA; NYSE)

The LIBs increasingly dominate this and other revenue lines industry-wide. In fact, these 10 firms account for well over half of the total industry's "other securities related" revenue, the highest of their large market shares in various industry activities. With only 14% of the workforce but 31% of industry capital, these firms' investment banking and risk-related business lines have allowed them to capture not only 55% of "securities related" revenue but 32% of all revenues (and expenses), 37% of all underwriting revenue and, most importantly, 38% of all profits! They also hold half of the industry's assets and absorb half of all interest costs in the industry.

EXHIBIT 5


LARGE INVESTMENT BANKS' SHARE OF INDUSTRY AGGREGATES

Source: Securities Industry Database (SIA; NYSE)

In other words, LIBs have used capital and leverage to follow their strategic strategy of penetrating risk-based businesses by taking positions in companies and securities to tie business segments together. No longer are they just advisors to Corporate America but the evolution of American finance has required investment bankers to be partners as well, utilizing their capital, a trend that is underway overseas and beginning to be felt in U.S. commercial banking as well.

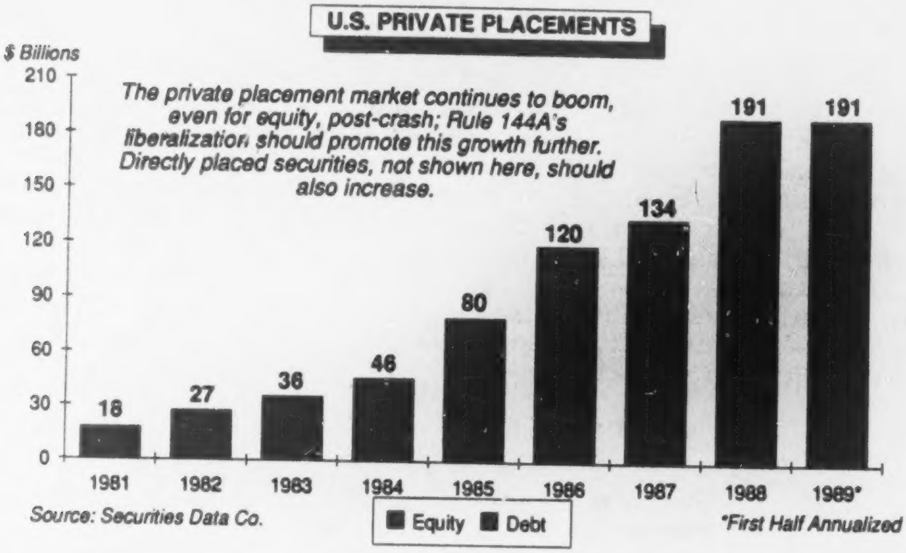
Conversely, the industry's main agency area, commissions, are now only 7% of the LIBs' revenue stream compared to still one-third for Regionals and about one-half for Discounters.

Much of the risk-based and fee-based business is falls into the "other revenue related" line. Private placement fees are one of the main sectors being reported here -- just how much we will now attempt to determine.

PRIVATE PLACEMENTS

Exhibit 6 shows the institutional market for privately placed securities has experienced unbroken growth; even for equity in the post-crash environment. This is a market dominated by LIBs and some NFL firms, as well as money center banks. With the SEC expected to vastly liberalize this market through regulatory changes (proposed Rule 144A - secondary trading of private placements) sometime by year-end, this growth should expand even further, particularly for foreign issuers; but with some degree of domestic new issue flow transferred from registered underwritten securities to the private placement market.

EXHIBIT 6



Source: Securities Data Co.

*First Half Annualized

Surprisingly, the U.S. private placement market is one of the world's largest securities markets. In its' Rule 144A release, the SEC states that the value of bonds outstanding in this market ranks fifth among the bond markets of the world and that the value of U.S. privately placed bonds outstanding equals total Eurobonds outstanding. Despite some private placements of equity (averaging around 8% of total placements the past few years), this is still dominantly a debt market.

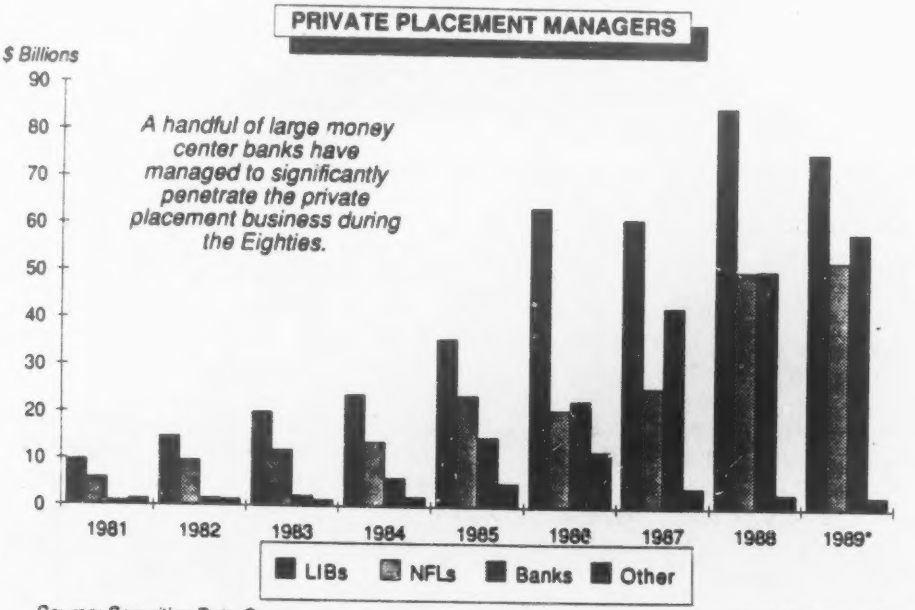
About 40-45% of placements are plain vanilla bonds, 10% are lease related debt financings, and 11% are M&A or acquisition related debt financing. Also, securitized bonds, mainly repackaged receivables, grew to 21% of all placements in 1987 but fell to just 11% last year. Meanwhile, privately placed CDs and deposit notes jumped from 10% of all placements in 1987 to 17% last year.

Banks, mainly money center commercial banks, have made sharp inroads as private placement managers this decade, and not just in CD/deposit notes but also, and in some cases mainly, in areas traditionally handled by investment banks. For instance, in 1989's first half, three of the top four managers of equity private placements were banks with a combined 30% market share. Since they are still prevented from doing public equity underwritings, these institutions have looked to the private placement markets to capture equity business.

Exhibit 7 shows the overall growth for the three main groups of managers of domestic private placements. Handling just under $1 billion, or 5%, of private placements in 1981, banks skyrocketed to managers of $51 billion last year, or 27% of the total placed (through agents and not sold directly), and will handle $60 billion, or 31%, this year based on first half results annualized.

The LIBs still dominate the area but have fallen from a 54% market share in the early Eighties to 40% this year while the NFLs have fallen from one-third to 28%. And with only 15 firms having more than a 1% market share, other types of securities firms have seen their combined market share fall from a high of 10% in 1986 to a mere 1% this year. Another growing trend, although figures are unavailable, is the direct placement of restricted securities with institutional investors, bypassing investment bankers entirely. Rule 144A's enactment is expected to accelerate this trend also.

EXHIBIT 7



A handful of large money center banks have managed to significantly penetrate the private placement business during the Eighties.

Source: Securities Data Co.

**First Half Annualized*

With the SEC's liberalized Rule 144A scheduled to take effect around December, we assume that the bulk of the expected increased business will still flow to these 15 firms. There have been comments that the SEC's proposals will allow only 100 of about 9,000 broker-dealers to participate in the private placement secondary market while allowing about 1,000 banks and S&Ls to meet the new "qualifications." However, only the very largest brokers and banks have a meaningful presence in this market now and this is unlikely to change, albeit with market share changes intra-group still very likely.

Fees in this market are not disclosed, and for that matter not all deals are disclosed or discovered by the tracking agencies. Nevertheless, we estimate that the total fees earned in this area probably amounted to $3 billion in 1988 and will match that again this year based on first half results.3/

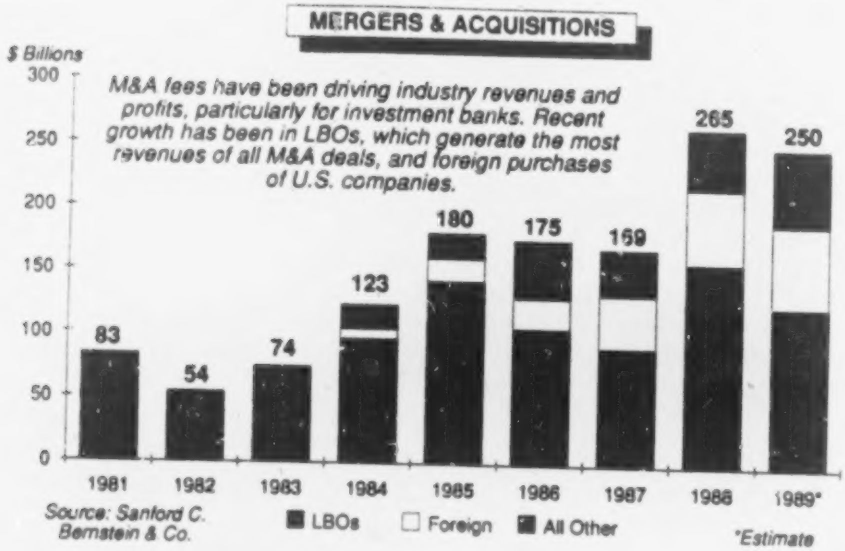
With 40%, or $1.2 billion, of these fees flowing to the LIBs, we estimate that private placements this year will make up about 6% of LIBs' total revenues or about the same amount they receive from commissions. This is also about 11% of their "other related revenue" FOCUS line, leaving the bulk, or $10 billion, still coming from the M&A-related and interest income areas. For NFLs, private placement fees last year (which should be matched this year) amounted to about $840 million -- 4% of their total revenues and 22% of their "other related" revenues. The amounts for all other NYSE firms are negligible.

M&A

The thrust of industry profitability since the crash, although its rise began in 1985, has been M&A related. Exhibit 8 maps out the growth of the the value of completed M&A deals during the Eighties. As is evident, leveraged buy outs (LBOs) have become one of the dominant factors in this area and generate the largest fees, about four times the average M&A fee (per $1 of transaction value) according to Sanford C. Bernstein research, and also generate auxiliary merchant banking fees from bridge loans, mezzanine financings, equity stakes of investment bank participants, etc. and ultimately IPO underwriting fees in some cases.

3/ This is a rough estimate which works out to about 150 basis points of reported volume (with a placement agent). It takes into account the higher, 300-400 b.p. spreads for high-yield and convertible securities, higher spreads for equity (approx. 200 bp's for pfd, 500-700 bp's for common), lower 50-100 bp's for straight debt, and the fact that reported volume is understated.

EXHIBIT 8



M&A fees have been driving industry revenues and profits, particularly for investment banks. Recent growth has been in LBOs, which generate the most revenues of all M&A deals, and foreign purchases of U.S. companies.

Source: Sanford C. Bernstein & Co.

*Estimate

Of the top 10 ranked M&A advisors last year, six were LIBs (and two more were in the top 16). We estimate that the LIBs brought in about $2.5 billion in M&A fees last year and may match this again in 1989 (based on first half results). This works out to one-third of their "other related" revenues as a group, although it ranged widely from near zero to near 100% firm to firm.

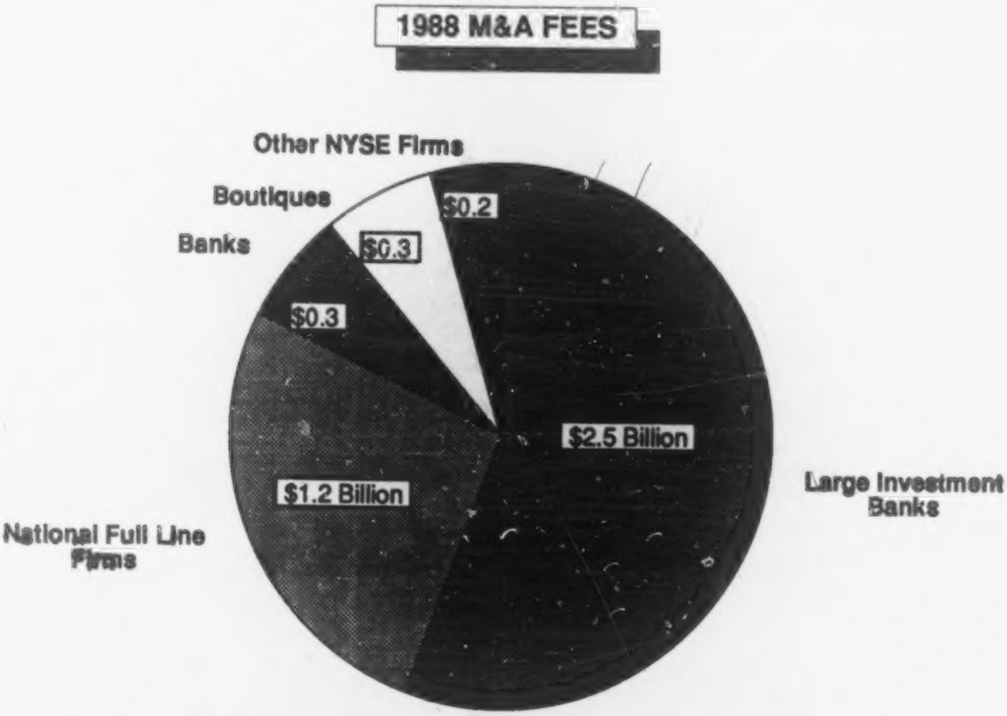
Two NFL firms were among the top five M&A advisors last year, another was in the top 10 and three others made the top-25 tier. We estimate that the NFL broker-dealers earned about $1.2 billion in M&A fees last year (and about the same projected for 1989). This is one-third of the group's "other related" revenues. On an individual basis, it again ranges widely from as little as zero up to a high of 75%.

Besides the LIBs and NFLs, the remaining M&A advisors with 1% or more of the business were mainly M&A boutiques such as KKR, Wasserstein Perella, Blackstone Group, etc., a few banks and other NYSE member firms.

However, of the $5.5 billion in "other related" revenue not attributable to LIBs and NFLs, nearly all is booked by the New York City-based firms, which includes all of the major foreign firms with advisory businesses. These firms are not "the major players" but they certainly outnumber the LIBs and NFLs and relative to their own income statements, the advisory business is important.

We estimate that both banks and the boutiques earned about $300 million each in direct M&A fees last year with about $200 million earned by other NYSE member firms.

EXHIBIT 9



1988 ESTIMATED M&A FEES TOTAL $4.5 BILLION

INTEREST INCOME

The only other major remaining "other related" revenue segment is interest income, other than margin interest. Again, the FOCUS reporting form is deficient in determining a major, and growing, securities industry revenue and income base.

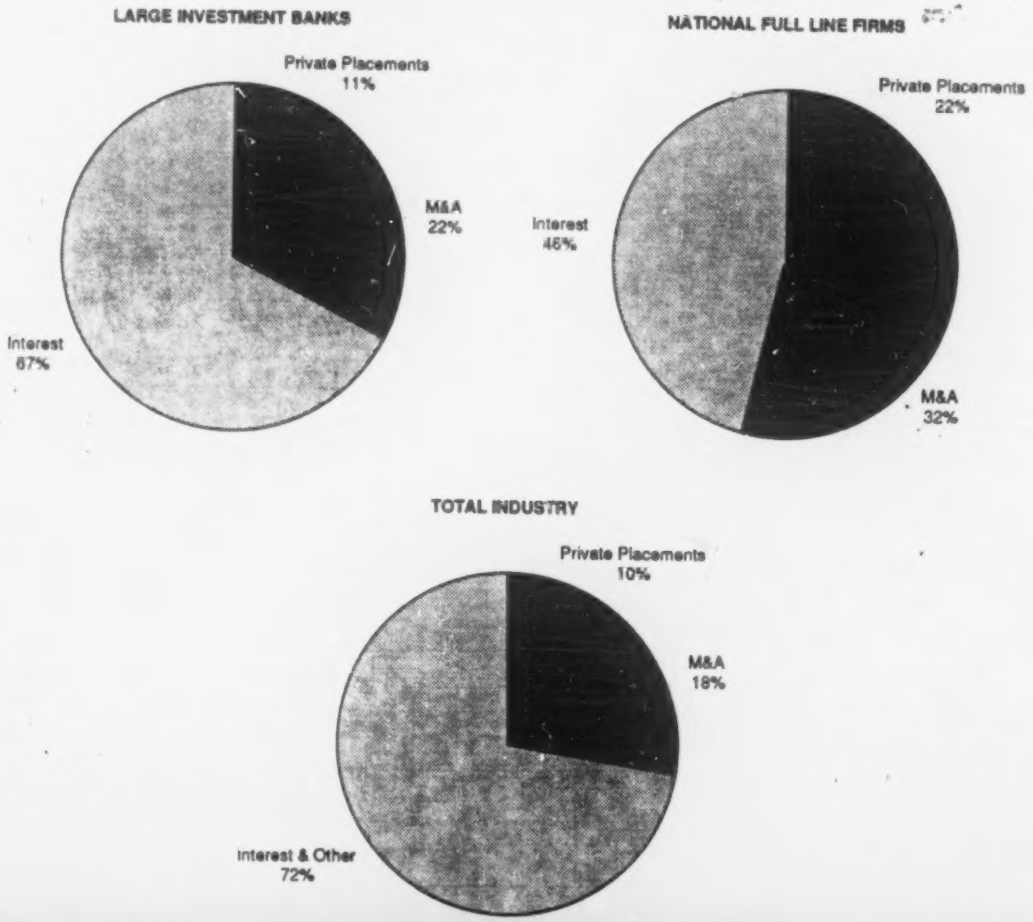
Before attempting to analyze this area, there are a few important points to be made. There is no standard reporting requirement for this area -- even for the publicly-held brokerages. Some firms report grossed-up interest revenue and interest expense while others report net interest income. This is an apples and oranges problem when trying to compare performance measures such as gross profit margin. Profit margins using net interest income will be higher than if gross interest (a larger denominator) is reported as revenues. Also, various sourced interest may be distributed throughout the revenue sheet, i.e. in trading revenues, investment revenues, margin revenues, other related revenues, etc.

Although we know that FOCUS reporting is not uniform, complete or necessarily accurate, the data indicate that for the most part, a good portion of interest revenue is being reported on a gross basis and shown in the "other related" line.

For the LIBs, just three publicly held firms had gross interest revenue approaching $7 billion last year. That alone almost equals the $7.4 billion of "other related" revenues not attributable to M&A and private placement fees. Although these firms have, on average, 30% of their total revenues outside the broker-dealer (FOCUS) unit, their broker-dealer units account for only 45% of the total LIBs and this group (and NFLs) appear to be the most accurate FOCUS reporters. Therefore, we estimate that the vast majority, if not entire, portion of this $7.4 billion in remaining "other related revenue" is interest income (**Exhibit 10**). Also, the growth in this line correlates with growth in related balance sheet items, such as the repo book and other debt inventory.

EXHIBIT 10

OTHER REVENUE RELATED TO THE SECURITIES BUSINESS
"An Attempt at a Breakdown"



Similarly, the publicly held NFLs alone had gross interest revenue totaling nearly $12 billion. Although half of the NFLs' revenues fall outside of the FOCUS reporting broker-dealer, this figure vastly exceeds NFLs' "other related" revenue, even before adjusting for M&A and private placements. Again, we estimate that the balance of $1.8 billion of "other related" revenues must be all interest income.

With no meaningful sample group of non-LIB, non-NFL firms being publicly held, we cannot attempt to determine what level of revenue is from interest sources. Although there are a significant amount of firms reporting all sorts of revenue on this line, we still believe the majority of the remaining balance is interest income.

UNDERWRITING

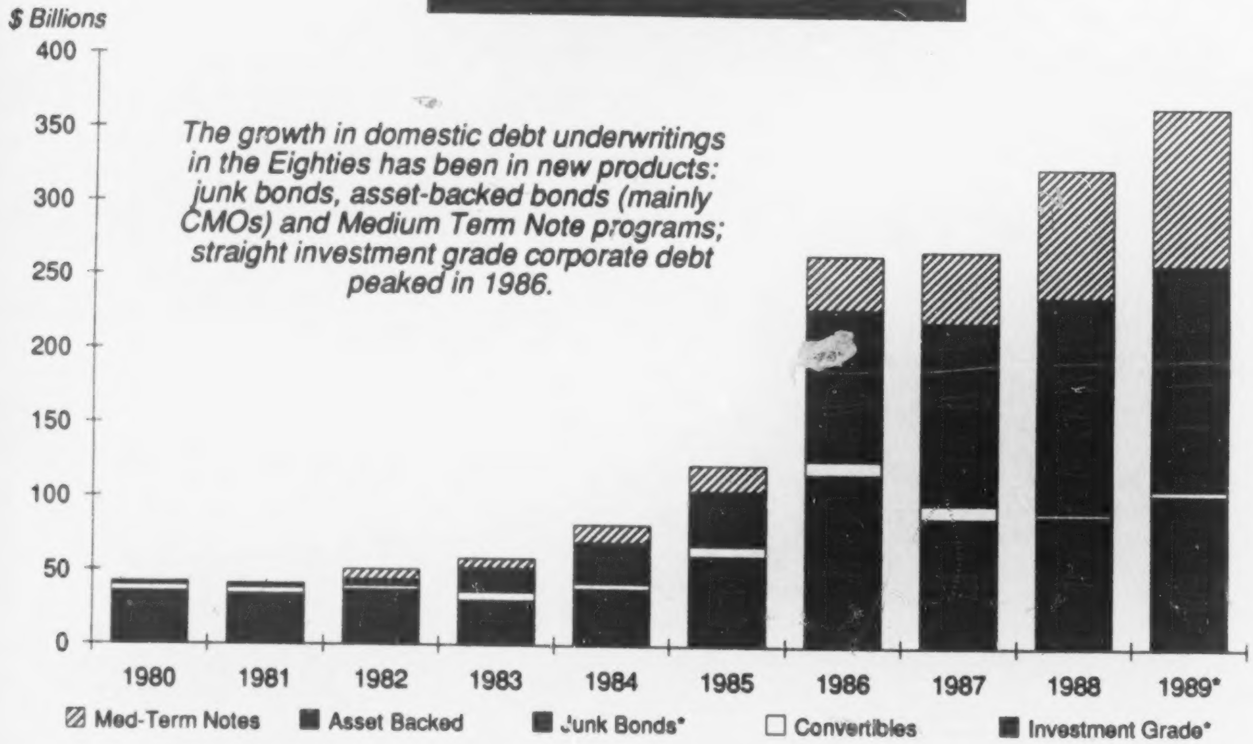
Besides these "other related" revenues which have driven industry profitability, there are other capital markets areas still bringing in steady revenues. A major source comes from the underwriting area, although corporate offerings have been soft since the crash and municipal offerings have nose-dived since TEFRA's enactment (with provisions placing limits on certain tax-exempt financings). This field is also dominated by the LIBs, NFLs and for "allowed" securities, i.e. municipal G.O. Bonds, banks (although their entrance into "non-allowed" securities is now being shepherded by their own regulators).

Municipal underwritings have been marginally profitable at best the past few years (and indeed the industry has witnessed a widespread contraction in this business, even seeing the top ranked municipal underwriter completely exit the business). The corporate side has also experienced a shrinkage in spreads, business concentration and a slowdown in issuance growth, but is still bringing in a steady stream of revenues to those in the field. In aggregate volume, these underwritings have actually continued to grow, however not in traditional areas.

Corporate straight bond new issues have been basically flat during the Eighties with the only growth coming from the "high-yield" sector. Repackaged mortgages and consumer receivables (auto loans, credit card debt, etc.) have been one of the fastest growing underwritten products as seen in Exhibit 11's "asset-backed" growth. Also, medium-term note programs, more of a revolving credit facility offered by underwriters than a traditional bond underwriting, have grown dramatically. Some of these debt products, however, may flow to the private market after Rule 144A is finalized and will still be dominated by investment banks, but at presumably lower fees and with bank competition added to the already stiff competition amongst broker-dealers.

EXHIBIT 11

DOMESTIC DEBT UNDERWRITINGS

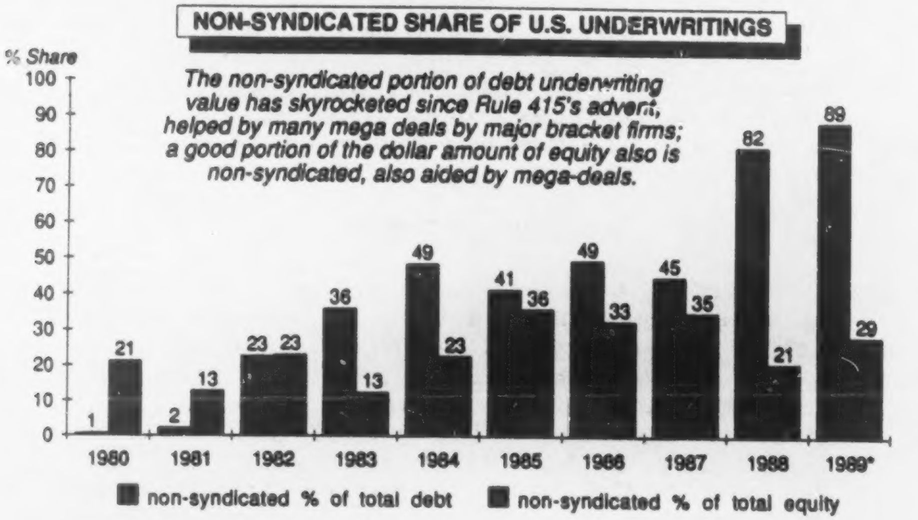


Source: Securities Data Co. *Straight (non-convertible) corporate bonds only; 1989 = 9 months annualized

Another SEC rule which heralded a change in the capital market competitive structure was Rule 415 enacted in 1982. This year, nearly 90% of the value of all bond underwritings will be handled strictly by one or several co-managers with no syndication at all (**Exhibit 12**). That compares to nearly 80% being fully syndicated to a wide range of firms during Rule 415's first year and nearly total syndication prior to its enactment.

The figures reflect more than one trend. Mega-deals have become more frequent and account for a large and growing share of the bond totals. These deals are often sole-managed and thus tilt the overall total towards the non-syndicated side. Also, the business is increasingly concentrated among the New York major bracket firms, the same firms which are not syndicating most of their deals. Still, the ultimate result is that there is far less volume of new issues for non-originating firms to participate in as underwriters or selling group members. And certainly the smaller, syndicated regional deals in no way make up for the lost business. Dramatizing the point, Regional firms accounted for 19% of all underwriting revenues in 1980 -- last year, their share was half this level, or 10%.

EXHIBIT 12



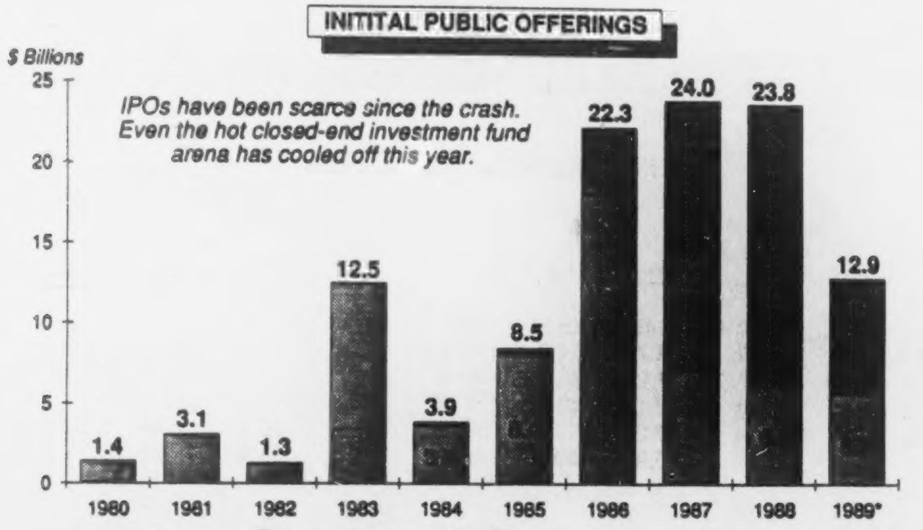
Source: Securities Data Co.

*Nine months annualized

Equity underwritings have not been fully affected by this trend. However, the larger and often best deals, if not technically non-syndicated, are often cited as having the bulk of their distribution also kept in the hands of the lead manager or a few co-managers.

One traditional area that remained more widely syndicated because of its inherently larger risk is initial public offerings, IPOs. This is also the most profitable underwritten product in terms of underwriting spreads. However, this area is also increasingly being concentrated at a few firms and even if it were not, the crash has practically closed the door to these offerings over the past few years.

EXHIBIT 13



Source: SDC

*Nine Months Annualized

Taken together, underwriting, principal transactions (trading and investments) and the "other related" revenue line, we see 64% of the industry's revenue in these "risk-based" lines. Also, the NFLs and LIBs which make up just 5% of the NYSE broker dealer-community have 72% of this total business. Therefore, industry aggregates today are telling the story of the largest firms only. To see how the rest of the industry is faring, we have to look at each constituency individually.

REGIONAL FIRMS

This year's second quarter was really a godsend for many Regional firms which have been having an extremely tough time since the crash. Pre-tax profits in 2Q were $81 million for the Regionals, an almost seven-fold increase from 1Q and the highest level since the 1Q87. Most of the gain came from increased commission business which jumped $64 million to $437 million, a level 33% higher than one year earlier (2Q88). Again, this is not likely to be repeated in 3Q since volume trailed off after June and was particularly slow in September.

Year-to-date, the Regionals are on track for a 75% improvement in profitability with full-year earnings projected to climb to $189 million from last year's slim $107 million. Still, that is far short of 1987's $271 million tally and way behind the $550 million booked in 1986. **Exhibit 14** shows how tight the margins have become, and not just for Regionals.

EXHIBIT 14

PRE-TAX PROFIT MARGINS

(In Percent)

Firm Category	80	81	82	83	84	85	86	87	88	89*
National Full Line	10.9	6.9	8.8	8.6	(0.9)	5.6	6.9	(0.9)	(0.3)	0.5
Large Investment Banks	17.7	15.4	17.4	16.7	11.4	14.6	13.5	4.7	8.4	4.7
Regionals	14.7	11.2	11.1	12.6	2.6	9.4	11.0	5.5	2.6	3.9
New York City Based	14.8	12.6	14.0	18.3	8.9	12.3	16.1	2.9	7.4	5.4
NYSE Discounters	17.5	12.2	13.6	14.0	0.3	8.9	15.7	8.6	3.1	8.5
Total Industry	**14.1**	**10.8**	**13.1**	**12.9**	**5.2**	**10.7**	**11.0**	**2.2**	**4.8**	**4.1**

PRE-TAX RETURN ON EQUITY

(In Percent)

Firm Category	80	81	82	83	84	85	86	87	88	89*
National Full Line	45.0	24.6	29.8	28.1	(2.6)	17.9	20.3	(2.5)	(0.7)	1.1
Large Investment Banks	55.7	56.7	54.8	43.8	31.1	38.5	34.2	15.5	20.4	11.4
Regionals	N.A	37.2	36.0	40.5	6.8	29.0	32.7	17.2	5.4	9.1
New York City Based	N.A	42.1	43.3	50.7	19.9	31.2	38.3	6.2	15.0	14.9
NYSE Discounters	N.A	52.2	53.9	46.7	0.8	25.6	49.5	22.5	5.0	16.5
Total Industry	**49.2**	**35.9**	**40.5**	**36.6**	**13.3**	**29.4**	**28.6**	**6.1**	**9.9**	**9.2**

** First Half Annualized*

Since 1987, Regionals have averaged a 4% profit margin, well below the 10% margins earned from 1981 to 1986. Similarly, ROE has averaged only 11% from 1987-89 compared to 30% for the rest of the Eighties. This, of course, is not only a problem at the Regionals, as the industry's profit margin is one-third its early 1980 levels and ROE is down to one-quarter its' earlier level!

Taking a look at Regionals' 1H89 performance annualized shows the biggest gain this year is commissions, up 22.3% over 1988 levels. Mutual fund sales are up about 20% but are still less than half their 1986 level. Regionals' "Other related" revenue, the big push for the LIBs and NFLs, is only up 3.8% this year. Still, total revenues are climbing about 15% from 1988's poor showing.

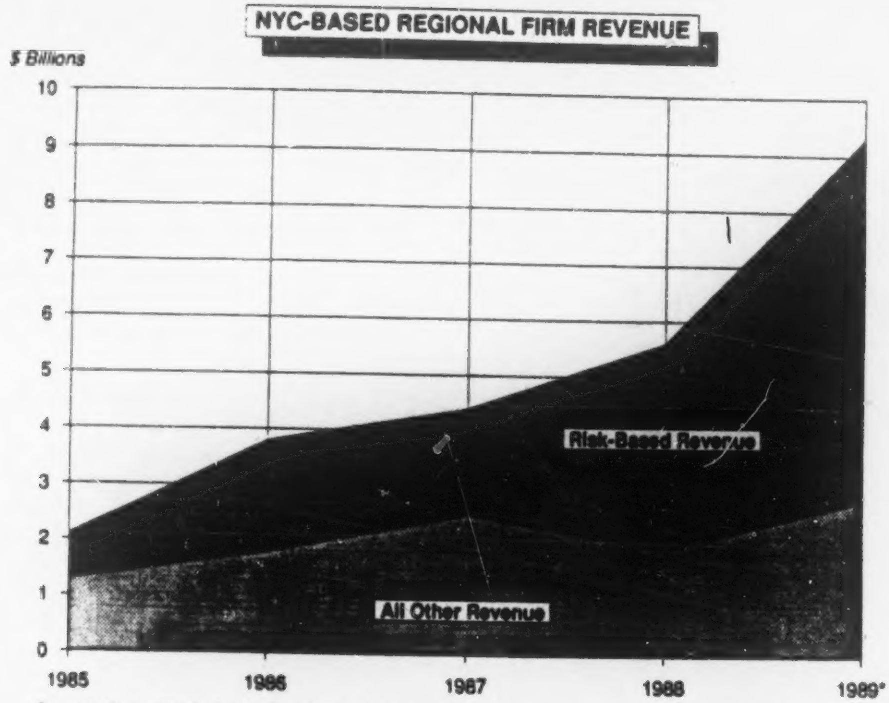
However, expenses are heading up also. Compensation costs are rising 10% this year following last year's 17% slash in this cost. Compensation actually bottomed out in 2Q88 and by 2Q89 have climbed back up to levels almost equal to those being spent just before the crash. However, the uptick is coming from increased broker production since clerical compensation has been checked: falling at a 3% rate this year following a 9% cut last year. Employment levels at the Regionals continued to hit new lows in 2Q; since the crash, the producer and clerical workforce is down 19% and 17%, respectively.

Floor costs are also shooting up over 20%, based on first half results, while interest expense will climb 37% or by $150 million by year's end. The only other expenses in check this year are technology expenditures (communications, EDP) which are holding even to last year's levels, and promotional costs, down 7%. Everything else is up with a resultant 13% projected increase in total expenses for the year.

NYSE DISCOUNTERS

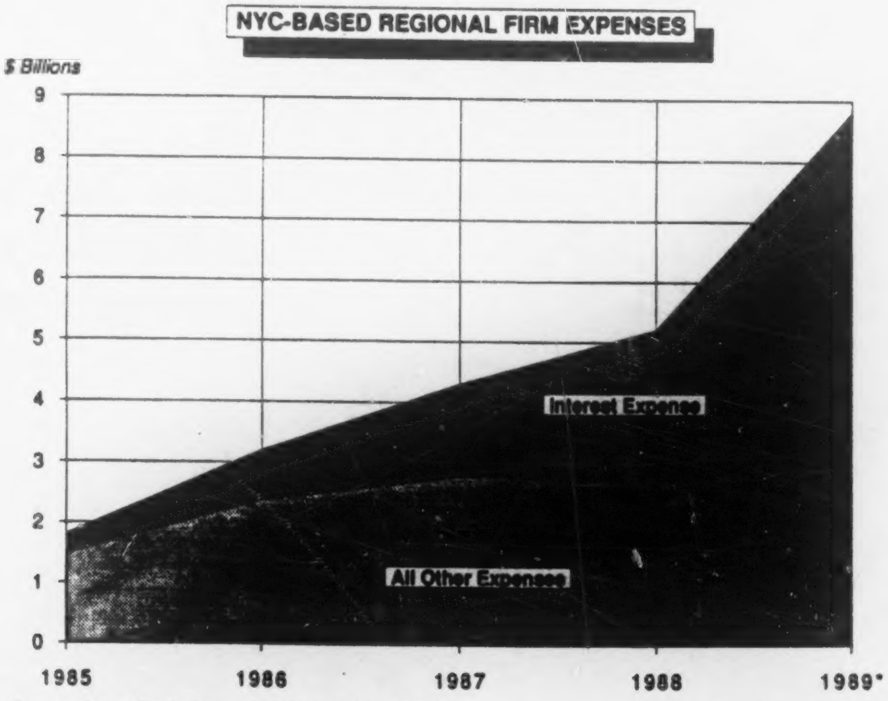
Discounters were initially the least affected by the crash, receiving record commissions in 4Q87 on crash inflated sell volume. The group only lost money in that quarter due to one customer's bad debts at one firm. But with the crash chasing the individual investor out of the market, 1988 was the leanest period for this group since 1984. Pre-tax profits per quarter last year ranged in the meager $7 to $10 million area. This shot up to $24 million in 1Q and $29 million in Q2, for a projected 250% increase in profitability by year's end. However, the key to maintaining this track for discounters is retail commissions, and we expect 3Q's levels in this area to retrench. October's recent events may again temporarily boost commission revenues but the longer-term impact of the volatility on the retail investors' psyche has yet to be gauged.

EXHIBIT 15



Source: Securities Industry Database (SIA; NYSE)

**First Half Annualized*



Source: Securities Industry Database (SIA; NYSE)

**First Half Annualized*

NYC-BASED REGIONAL FIRMS

NYC-Based Regionals in many ways now mirror the LIBs. Their revenues, particularly "other related" revenue, has continued to mushroom despite the crash. Over 70% of their revenues this year have been from risk-based activities with 42% of total revenues coming from "other related," mainly interest income, and 23% from trading. Conversely, 63% of their expenses in 1989 have been interest costs (**Exhibit 15**).

These increases have come despite the group's shrinkage from 80 firms to 75 firms since the crash. The NYCs' employment levels are also up, despite the industry's net job loss of 33,000 positions. Producers are up 14% from their pre-crash levels while clerical staff is up 2%.

The group, however, includes all of the foreign firms headquartered in New York, particularly the Japanese, Canadian and European NYSE member firms, which have been trying to expand their U.S. presence.

Further, after seeing their profits plummet from a record $618 million in 1986 to $129 million in 1987 (all due to 4Q losses), the NYCs' pre-tax profits rebounded to $416 million last year and is up another 20% this year, to an annualized projection of $500 million, not too far from their 1986 record.

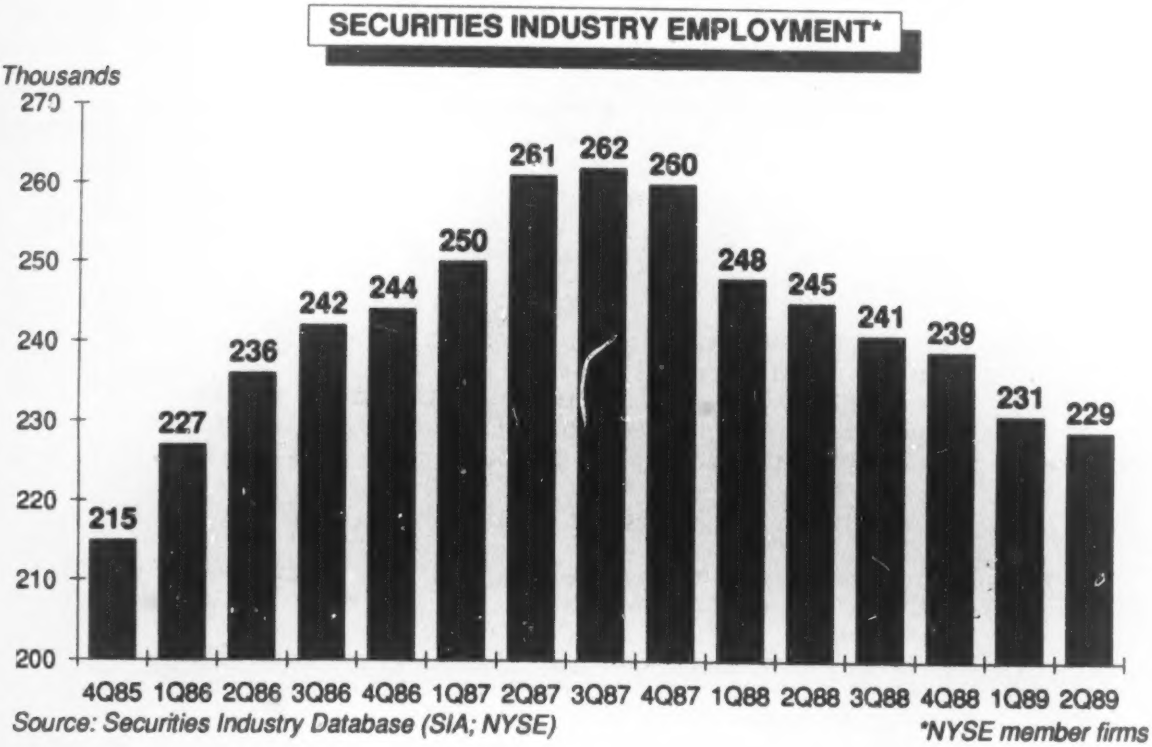
INDUSTRY WRAP-UP

Throughout most of this Trends, we've discussed the major issues affecting the LIBs and NFLs but a few additional points are worth covering. NFLs' compensation levels are again down this year, but only marginally. Total compensation has been gradually reduced from a high of $2.8 billion in 1Q87 to $2.1 billion in 4Q88, but has been creeping up to $2.3 and $2.4 billion in this year's first two quarters, respectively. And this is not solely from increased broker production this year -- both RR and clerical comp are rising again this year despite a continued reduction in both group's employment levels.

In fact, both the clerical and broker workforce at mid-year were back to late 1985, early 1986 levels at the NFLs! The LIBs have also continued the reductions in employment this year. Their producer and non-producer groups at mid-year equaled mid-year 1986 levels and are down about 17% since 1987. Nevertheless, total compensation expense has not been dented and this year's levels will be up slightly to a new record level. Although this is not a healthy sign for cost cutting success, compensation is relatively a much smaller expense item for this group: 22% of total revenues vs. interest expense's 50% share.

Exhibit 16 shows the overall employment trend at the NYSE broker-dealers since late 1985. There has been a 33,000, or 13%, reduction in the workforce in two years; however, this brings the industry only back to 1986 levels which, it must be remembered, were double the employment levels of the industry as the Eighties began.

EXHIBIT 16



Source: Securities Industry Database (SIA; NYSE)

**NYSE member firms*

Finally, we illustrate the income statement of the "securities industry" in **Exhibit** 17. It compares this year's first half results annualized (doubled) to last year's full-year report. Besides being only the broker-dealer reporting of NYSE members, we have discussed why this statement no longer accurately reflects "the industry." Are industry revenues and expenses up 16% for the typical firm this year? Are profits the past two years each double 1987's level or half the record levels of 1986? Not for most firms.

EXHIBIT 17

NYSE BROKER-DEALER INCOME STATEMENT

(In $ Millions)

REVENUE:	1988	1989*	88 - 89* % Change
Commissions	8,790.5	10,111.0	15.0%
Trading Gains	11,299.1	13,158.6	16.5%
Investment Gains	1,394.2	802.4	-42.4%
Underwriting Revenue	5,158.2	3,839.2	-25.6%
Margin Interest	3,028.5	3,693.0	21.9%
Mutual Fund Sales	1,413.3	1,457.6	3.1%
Fees, Account Supervision	1,884.8	1,945.0	3.2%
Research	23.1	22.4	-3.0%
Commodities	1,382.3	1,525.6	10.4%
Other Securities Related	14,693.1	20,415.8	38.9%
Other Unrelated	2,761.7	3,002.4	8.7%
TOTAL REVENUE	51,828.9	59,972.6	15.7%
EXPENSES:			
Total Compensation	18,739.4	19,197.0	2.4%
RR Compensation	7,580.6	7,460.4	-1.6%
Clerical Compensation	9,280.5	9,561.0	3.0%
Floor Costs	1,756.2	1,902.0	8.3%
Communications	2,548.8	2,437.0	-4.4%
Occupancy & Equipment	3,052.4	3,096.4	1.4%
Promotional Costs	1,003.5	968.6	-3.5%
Interest Expense	16,308.2	23,725.2	45.5%
Errors, Bad Debts	438.1	277.4	-36.7%
EDP	736.6	715.2	-2.9%
Regulatory Fees	371.9	395.6	6.4%
Non-Recurring Charges	56.1	87.0	55.1%
Other	4,325.2	4,729.6	9.3%
TOTAL EXPENSES	49,336.4	57,530.8	16.6%
PRE-TAX NET INCOME	2,492.4	2,441.8	-2.0%

*First Half Annualized

As we've mentioned throughout most of this Trends, investment banking is driving most of the industry's upward results since the crash, that these businesses are concentrated within a few large firms, and even these results are understated since a vast amount of the LIB and NFL businesses are conducted outside their broker-dealer reporting entity.

Nevertheless, we estimate that 3Q results will somewhat temper these annualized projections and with October's uncertain markets, full-year 1989 may have some new surprises in store for us.

George R. Monahan
Director of Industry Studies

VOLUME

	SEPT. 1989	YTD 1989	SEPT. 1988	YTD 1988	% CHG YTD 1989-1988
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	151.8	166.1	145.7	167.3	-0.7%
AMEX (MILS.)*	12.6	12.4	8.4	10.1	22.5%
NASDAQ (MILS.)*	131.3	132.5	111.8	125.1	6.0%
REGIONAL EXCHANGE (MILS.)*	24.5	26.5	21.5	23.1	14.6%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$120,174	$1,165,773	$101,435	$1,044,556	11.6%
AMEX (MILS.)	4,504	30,502	2,463	25,321	20.5%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	9,255	88,771	6,759	64,282	38.1%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	15,336	155,630	14,805	133,588	16.5%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	49.0%	51.6%	54.7%	55.4%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	9,688	97,368	8,841	81,063	20.1%
AMEX OPTIONS	3,740	31,033	2,761	27,466	13.0%
COMMODITY	19,888	206,009	20,185	184,463	11.7%

*MONTHLY AVERAGE

N/A - DATA NOT AVAILABLE

PRICES
(END OF MONTH)

	SEPT 1989	SEPT 1988	% CHG SEPT 1989-1988
DOW JONES INDUSTRIALS	2692.82	2112.91	27.45%
STANDARD & POOR'S 500	349.15	271.91	28.41%
NYSE COMPOSITE	193.97	153.57	26.31%
AMEX MARKET VALUE INDEX	388.76	301.63	28.89%
VALUE LINE COMPOSITE	275.26	234.71	17.28%
NASDAQ COMPOSITE	472.92	387.71	21.98%

YIELDS
(MONTHLY AVERAGES)

	SEPT 1989	SEPT 1988	BASIS POINT CHG 1989-1988
BOND BUYER INDEX (20 BOND)	7.26%	7.66%	(40)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	9.01	9.82	(81)
Baa CORPORATE	9.91	10.90	(99)
RATIO Aaa CORPS. TO Baa CORPS.	0.91	0.90	1

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UNDERWRITING

	SEPT 1989	SEPT 1988	% CHANGE 1989-1988
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$24,211.3	$26,411.0	-8.3%
Common Stock	$2,238.3	$2,367.2	-5.4%
# of Common Stock Issues	43	33	30.3%
Preferred Stock	$719.0	$277.0	159.6%
# of Preferred Stock Issues	4	8	-50.0%
Corporate Debt	$21,254.0	$23,766.8	-10.6%
# of Corporate Debt Issues	102	133	-23.3%

Source: Securities Data Co.

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
International Tax Comparisons	Prepared in conjunction with Spicer & Oppenheim, this study provides an overview of the taxation of gains, dividends and interest on portfolio stock investments of individuals in the U.S. and ten other industrialized countries and six Pacific Basin countries.	Securities Industry Association Contact: Carolyn Hildebrandt
Asset Securitization: A Supervisory Perspective	The increase in asset backed securities has led to increasing concern over the supervision of these products. The first section of this article explores mechanics, structure, and incentives for asset-backed securities. A second section outlines issues relating to supervision and sales treatment of asset securitization transactions.	Federal Reserve Bulletin October 1989
Third Quarter 1989 Financing Rankings	For the seventh straight quarter, Merrill Lynch topped the charts as the lead domestic underwriter with $35.3 billion in new issues. The volume of total domestic issues through September 30 was also about the same at $214.9 billion, a slim 3.8% rise. Statistical data ranked by type of underwriting, including mortgage-backed and asset-backed securities.	Investment Dealers' Digest 10/9/89
Europe's Internal Market: What Are They Building	A survey of non-European worries regarding Europe 1992, how much they are justified, what 1992 could do for the world's trading system and how it has altered perceptions of the EEC abroad. Underlying all these attitudes is the question: what is the European Community really building. This survey attempts to help answer this question.	The Economist 8-14/7/89

Item	Description	Source
Bank Intermediation, Bank Runs, and Deposit Insurance	This article examines the reasons why government provides deposit insurance and how the provision of deposit insurance can improve economic performance. While it is argued that the reason for deposit insurance is to promote financial stability by preventing bank runs, the insurance may, however, allow excessive risk taking. This trade-off is examined as well as alternatives to deposit insurance.	FDIC Banking Review Office of Corporate Communications 550 17th Street, N.W. Washington, D.C., 20429 Spring/Summer 1989 Vol.2, No.1
Primary Commodities: Market Developments and Outlook	This study provides an analysis of the market developments in 1988 with respect to primary commodities and the outlook for these commodities in the near and medium term. Attention is focused on the major non-fuel primary commodities traded in international markets.	International Monetary Fund Commodities Division of the Research Department Washington, D.C. 20431 July, 1989
The Japanese Response to U.S.-Canada Free Trade	For the Japanese, the creation of the U.S.-Canada free trade agreement poses both opportunities and threats. This report looks at the Japanese reaction to the FIA through the eyes of Japanese businessmen in Canada and the U.S. Also looks at the U.S-Canada-Japan trading triangle.	The Institute for U.S.-Canada Business Studies Pace University Guy Stanley
Attitudes and Behavior of Affluent Investors	A major new market research study into investor attitudes and behavior. Questions such as "Who do affluent investors consider their primary financial advisor?", or, "What are your client's attitudes toward risk", are answered. The study also includes a transcript of the presentation of the findings to the SIA Sales and Marketing Conference, and interpretation of the data by a panel of industry experts.	Securities Industry Association Cost: SIA members - $75, non-members - $150. Contact: Richard J. Thornblad

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NAVAL SHIPBUILDING

Shipbuilders Council of America ▪ *1110 Vermont Avenue, N.W., Washington, D.C. 20005-3553*

December 1, 1988 NAVAL SHIPBUILDING REPORT

Naval Vessels Under Construction

PRIVATE SHIPYARDS NEW CONSTRUCTION

Symbol	Type	No. of Vessels	Total Light Disp. Tons
AGOR	Oceanographic Research Ship	1	2,100
AOE	Fast Combat Support Ship	2	39,400
CG	Guided Missile Cruiser	16	142,560
CVN	Aircraft Carrier (Nuclear)	4	284,000
DDG	Guided Missile Destroyer	3	24,900
FFG	Guided Missile Frigate	1	2,727
LHD	Amphibious Assault Ship	4	114,000
LSD	Dock Landing Ship	6	67,394
MCM	Mine Countermeasures Ship	7	7,000
MHC	Coastal Minehunter Ship	1	780
SSBN	Ballistic Missile Submarine (Nuclear)	8	100,000
SSN	Attack Submarine (Nuclear)	20	120,000
T-AGOS	Ocean Surveillance Ship (Monohull)	7	11,200
T-AGOS	Ocean Surveillance Ship (SWATH)	4	9,944
T-AGS	Oceanographic Survey Ship	2	17,620
T-AO	Fleet Oiler	10	95,000
WMEC	Medium Endurance Cutter (USCG)	3	3,600
	TOTAL	99	1,042,225

PRIVATE SHIPYARDS CONVERSIONS AND MODERNIZATIONS

Symbol	Type	No. of Vessels	Total Light Disp. Tons
AO(J)	Fleet Oiler(Jumbo)	4	46,430
T-ACS	Crane Ship	2	33,200
T-AG	Acoustic Research Ship	1	4,037
	TOTAL	7	83,667

NEW NAVAL VESSEL CONSTRUCTION
December 1, 1988

PRIVATE SHIPYARDS

Shipyard	Navy No.	F.Y. Program	Date	Name	Light Disp. Tons	Actual Launch Date	Est. Delivery
AVONDALE INDUSTRIES	T-AO-194	'86	6/88	JOHN ERICSSON	9,500		9/90
Westwego, Louisiana	T-AO-195	'86	2/86	LEROY GRUMMAN	9,500	KL	5/89
	T-AO-196	'87	6/88	KANAWHA	9,500		6/91
	T-AO-197	'87	2/87	PECOS	9,500	KL	3/90
	T-AO-198	'88	6/88	----------	9,500		10/91
	T-AO-200	'88	10/88	----------	9,500		7/92
	T-AO-202	'89	10/88	----------	9,500		3/93
	T-AO-204	'89	10/88	----------	9,500		12/93
	LSD-44	'84	11/83	GUNSTON HALL	11,100	6/87	1/89
	LSD-45	'85	11/84	COMSTOCK	11,100	1/88	6/89
	LSD-46	'85	11/84	TORTUGA	11,100	KL	11/89
	LSD-47	'86	12/85	RUSHMORE	11,100	KL	4/90
	LSD-48	'86	12/85	ASHLAND	11,100		8/90
	LSD-49(CV)	'88	6/88	----------	11,894		11/93
BATH IRON WORKS, CORP.	CG-58	'84	12/83	PHILIPPINE SEA	8,910	7/87	1/89
Bath, Maine	CG-60	'85	11/84	NORMANDY	8,910	3/88	10/89
	CG-61	'85	11/84	MONTEREY	8,910	KL	3/90
	CG-63	'86	1/86	COWPENS	8,910	KL	7/90
	CG-64	'86	1/86	GETTYSBURG	8,910	KL	11/90
	CG-67	'87	4/87	SHILOH	8,910		12/91
	CG-70	'88	2/88	----------	8,910		12/92
	DDG-51	'85	4/85	ARLEIGH BURKE	8,300		2/91
	DDG-53	'87	9/87	JOHN PAUL JONES	8,300		7/92
BETHLEHEM STEEL CORP.	T-AGS-39	'85	6/85	MAURY	8,810	9/87	12/88
Sparrows Point, Maryland	T-AGS-40	'85	6/85	TANNER	8,810		7/89
GENERAL DYNAMICS CORP.	SSBN-734	'81	1/82	TENNESSEE	12,500	12/86	12/88
ELECTRIC BOAT DIVISION	SSBN-735	'83	11/82	PENNSYLVANIA	12,500	4/88	8/89
Groton, Connecticut	SSBN-736	'84	11/83	WEST VIRGINIA	12,500	KL	4/90
	SSBN-737	'85	8/85	KENTUCKY	12,500	KL	12/90
	SSBN-738	'86	3/86	MARYLAND	12,500	KL	12/91
	SSBN-739	'87	5/87	NEBRASKA	12,500	KL	12/92
	SSBN-740	'88	1/88	----------	12,500		1/94
	SSBN-741	'89	10/88	----------	12,500		10/94
	SSN-752	'83	11/82	PASADENA	6,000	9/87	12/88
	SSN-754	'84	11/83	TOPEKA	6,000	1/88	4/89
	SSN-755	'84	11/83	MIAMI	6,000	KL	10/89
	SSN-757	'85	11/84	ALEXANDRIA	6,000	KL	4/90
	SSN-760	'86	3/86	ANNAPOLIS	6,000	KL	10/90
	SSN-761	'86	3/86	SPRINGFIELD	6,000		3/91
	SSN-762	'86	3/86	COLUMBUS	6,000		7/91
	SSN-763	'86	3/86	SANTA FE	6,000		11/91
	SSN-768	'88	6/88	----------	6,000		4/93
INGALLS	CG-59	'84	12/83	PRINCETON	8,910	10/87	12/88
SHIPBUILDING, INC.	CG-62	'85	11/84	CHANCELLORSVILLE	8,910	7/88	8/89
Pascagoula, Mississippi	CG-65	'86	1/86	CHOSIN	8,910	KL	11/90
	CG-66	'87	4/87	HUE CITY	8,910		6/91
	CG-68	'87	4/87	ANZIO	8,910		12/91
	CG-69	'88	2/88	----------	8,910		9/92
	CG-71	'88	2/88	----------	8,910		3/93
	CG-72	'88	2/88	----------	8,910		6/93
	CG-73	'88	2/88	----------	8,910		1/94
	DDG-52	'87	5/87	JOHN BARRY	8,300		9/91
	LHD-1	'84	2/84	WASP	28,500	8/87	3/89
	LHD-2	'86	9/86	ESSEX	28,500		4/92
	LHD-3	'88	11/87	KEARSARGE	28,500		1/93
	LHD-4	'89	10/88	----------	28,500		4/94
INTERMARINE USA	MHC-51	'86	5/87	OSPREY	780		7/91
Savannah, Georgia							
MARINETTE MARINE CORP.	MCM-2	'83	5/83	DEFENDER	1,000	4/87	7/89
Marinette, Wisconsin	MCM-4	'84	12/83	CHAMPION	1,000	KL	12/89
	MCM-7	'85	8/86	PATRIOT	1,000	KL	7/90

Shipyard	Navy No.	F.Y. Program	Date	Name	Light Disp. Tons	Actual Launch Date	Est. Delivery
McDERMOTT SHIPYARDS Morgan City, Louisiana	T-AGOS-19	'87	10/86	VICTORIOUS	2,486	KL	2/90
	T-AGOS-20	'88	10/88	----------	2,486		1/91
	T-AGOS-21	'88	10/88	----------	2,486		4/91
	T-AGOS-22	'88	10/88	----------	2,486		10/91
NATIONAL STEEL AND SHIPBUILDING COMPANY San Diego, California	AOE-6	'87	1/87	SUPPLY	19,700		4/91
	AOE-7	'89	11/88	----------	19,700		6/92
NEWPORT NEWS SHIPBUILDING Newport News, Virginia	SSN-750	'82	4/82	NEWPORT NEWS	6,000	3/86	1/89
	SSN-753	'84	11/83	ALBANY	6,000	6/87	12/89
	SSN-756	'85	11/84	SCRANTON	6,000	KL	7/90
	SSN-758	'85	11/84	ASHEVILLE	6,000	KL	12/90
	SSN-759	'85	11/84	JEFFERSON CITY	6,000	KL	4/91
	SSN-764	'87	2/87	----------	6,000		11/91
	SSN-765	'87	2/87	----------	6,000		3/92
	SSN-766	'87	2/87	----------	6,000		7/92
	SSN-767	'87	2/87	----------	6,000		11/92
	SSN-769	'88	6/88	----------	6,000		4/93
	SSN-770	'88	6/88	----------	6,000		8/93
	CVN-72	'83	12/82	ABRAHAM LINCOLN	71,000	2/88	10/89
	CVN-73	'83	12/82	GEORGE WASHINGTON	71,000	KL	7/92
	CVN-74	'88	6/88	JOHN C. STENNIS	71,000		12/95
	CVN-75	'88	6/88	----------	71,000		6/98
PENNSYLVANIA SHIPBUILDING COMPANY Chester, Pennsylvania	T-AO-191	'85	5/85	BENJAMIN ISHERWOOD	9,500	1/88	8/89
	T-AO-192	'85	5/85	HENRY ECKFORD	9,500	KL	7/90
PETERSON BUILDERS, INC. Sturgeon Bay, Wisconsin	MCM-3	'84	12/83	SENTRY	1,000	9/86	12/88
	MCM-5	'84	12/83	GUARDIAN	1,000	6/87	6/89
	MCM-6	'85	8/86	DEVASTATOR	1,000	6/88	11/89
	MCM-8	'85	8/86	SCOUT	1,000	KL	9/90
ROBERT E. DERECKTOR OF RHODE ISLAND, INC. Middletown, Rhode Island	WMEC-911	'80	1/81	FORWARD	1,200	8/87	12/88
	WMEC-912	'80	1/81	LEGARE	1,200	8/87	4/89
	WMEC-913	'80	1/81	MOHAWK	1,200	5/88	8/89
TACOMA BOATBUILDING Tacoma, Washington	T-AGOS-11	'87	9/87	AUDACIOUS	1,600	KL	6/89
	T-AGOS-12	'87	9/87	BOLD	1,600	KL	9/89
TODD PACIFIC SHIPYARDS, INC. San Pedro, California	FFG-61	'84	11/84	INGRAHAM	2,727	6/88	6/89
TRINITY INDUSTRIES New Orleans, LA	T-AGOS-14	'85	4/85	WORTHY	1,600	2/88	12/88
	T-AGOS-15	'86	6/86	TITAN	1,600	6/88	3/89
	T-AGOS-16	'87	2/87	CAPABLE	1,600	KL	7/89
	T-AGOS-17	'87	2/87	INTREPID	1,600	KL	11/89
	T-AGOS-18	'87	2/87	RELENTLESS	1,600	KL	3/90
	AGOR-23	'88	6/88	----------	2,100		12/90

NAVAL VESSEL CONVERSIONS AND MODERNIZATIONS

December 1, 1988

AVONDALE INDUSTRIES Westwego, Louisiana	AO(J)-179	'87	7/88	MERRIMACK	11,699		12/90
	AO(J)-180	'88	7/88	WILLAMETTE	11,333		4/91
	AO(J)-178	'89	10/88	MONONGAHELA	11,699		10/91
	AO(J)-177	'89	10/88	CIMARRON	11,699		3/92
TACOMA BOATBUILDING Tacoma, Washington	T-AG-195	'86	2/87	HAYES	4,037		4/90
THE AMERICAN SHIPBUILDING COMPANY TAMPA SHIPYARDS, INC. Tampa, Florida	T-ACS-7	'87	9/87	DIAMOND STATE	16,600		12/88
	T-ACS-8	'87	9/87	EQUALITY STATE	16,600		2/89

EVENTS IN APRIL-NOVEMBER 1988

NEW CONTRACTS

Shipyard	Navy No.	Name	Type	Date
Newport News	SSN-769	----------	Attack Submarine	6/10/88
Newport News	SSN-770	----------	Attack Submarine	6/10/88
Halter	AGOR-23	----------	Oceanographic Research Ship	6/10/88
Avondale	LSD-49(CV)	----------	Dock Landing Ship(CV)	6/17/88
Avondale	T-AO-198	----------	Fleet Oiler	6/20/88
GD, EB	SSN-768	----------	Attack Submarine	6/30/88
Newport News	CVN-74	JOHN C. STENNIS	Aircraft Carrier	6/30/88
Newport News	CVN-75	----------	Aircraft Carrier	6/30/88
Avondale	AO(J)-179	MERRIMACK	Fleet Oiler(Jumbo)	7/15/88
Avondale	AO(J)-180	WILLAMETTE	Fleet Oiler(Jumbo)	7/15/88
Ingalls	LHD-4	----------	Amphibious Assault Ship	10/03/88
Avondale	AO(J)-178	MONONGAHELA	Fleet Oiler(Jumbo)	10/04/88
Avondale	AO(J)-177	CIMARRON	Fleet Oiler(Jumbo)	10/04/88
GD, EB	SSBN-741	----------	Ballistic Missile Sub	10/05/88
Avondale	T-AO-200	----------	Fleet Oiler	10/06/88
Avondale	T-AO-202	----------	Fleet Oiler	10/06/88
Avondale	T-AO-204	----------	Fleet Oiler	10/06/88
McDermott	T-AGOS-20	----------	Ocean Surveillance Ship	10/07/88
McDermott	T-AGOS-21	----------	Ocean Surveillance Ship	10/07/88
McDermott	T-AGOS-22	----------	Ocean Surveillance Ship	10/07/88
NASSCO	AOE-7	----------	Fast Combat Support Ship	11/03/88

VESSELS DELIVERED

NORSHIPCO	T-ACS-6	CORNHUSKER ST.	Crane Ship	4/12/88
Ingalls	CG-57	LAKE CHAMPLAIN	Guided Missile Cruiser	6/01/88
R.E. Derecktor	WMEC-910	THETIS	Medium Endurance Cutter	6/02/88
Newport News	SSN-723	OKLAHOMA CITY	Attack Submarine	6/28/88
GD, EB	SSN-751	SAN JUAN	Attack Submarine	6/30/88
Halter	T-AGOS-13	ADVENTUROUS	Ocean Surveillance Ship	8/19/88
Avondale	T-AO-193	WALTER S. DIEHL	Fleet Oiler	9/02/88
Ingalls	BB-64	WISCONSIN	Battleship	10/20/88

DELIVERIES BY U.S. PRIVATE SHIPYARDS*

	Actual					Future					
	1984	1985	1986	1987	1988	1988	1989	1990	1991	1992	1993
January	1	2(1)	0	1	1		3	0	1	0	1
February	3	3	3	2	1(1)		1(1)	1	1	0	0
March	1	1(1)	4(1)	0	0		2	3	1	2(1)	2
April	3(1)	1	2	3	1(1)		2	4(1)	4(1)	1	2
May	2	4(1)	3(1)	0	0		1	0	0	0	0
June	6(3)	5	0	3	4		4	0	2	1	1
July	4(1)	1	2	1	0		3	4	2	4	0
August	0	3(1)	1	4(1)	1		4	1	0	0	1
September	4(3)	4(2)	1	1	1		1	2	1	1	0
October	1(1)	2(2)	5(1)	2(1)	1(1)		3	1	-3(1)	0	0
November	5	7(1)	0	1		0	3	2	2	1	1
December	1	2	3(1)	1(1)		8(1)	2	4(1)	3	2	1
	31	35	24	19	10	8	29	22	20	12	9

* Six vessels are to be delivered after 1993
( ) Indicates number of conversions or modernizations in total for that year